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Supreme Court, U. S.
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In the Supreme Court of the United States

OCTOBER TERM, 1979

UNITED STATES OF AMERICA, PETITIONER

v.

ELWOOD SWANK AND RITA SWANK

UNITED STATES OF AMERICA, PETITIONER

v.

BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA, PETITIONER

v.

BULL RUN MINING CO., INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgments of the United States Court of Claims in these cases.

OPINION BELOW

The opinion of the Court of Claims (App. A, *infra*, 1a-16a) is reported at 602 F.2d 348.

JURISDICTION

The judgments of the Court of Claims were entered on December 7, 1979 in *Bull Run Mining Co.* and *Black Hawk Coal Corporation*, and on November 30, 1979 in *Swank* (App. B, *infra*, 17a-22a). By order dated February 21, 1980, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including March 29, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1255.

QUESTION PRESENTED

Whether a provision in a mineral lease permitting the lessor to terminate the lease on 30 days' notice without cause deprives the lessee of an economic interest in the minerals in place so that the lessee is not entitled to a depletion deduction under Sections 611 (a) and 613 of the Internal Revenue Code of 1954.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 611 and 613 of the Internal Revenue Code of 1954 (26 U.S.C.), and of Treasury Regulations on Income Tax, Section 1.611-1 (26 C.F.R.), are set forth in Appendix C, *infra*, 23a-25a.

STATEMENT

1. a. *Swank.* During 1966-1967, respondent Swank[1] was engaged in mining anthracite coal on various tracts located in Northumberland County, Pennsylvania. Swank had leased these tracts from Northumberland County under lease agreements dated October 24, 1964 and July 25, 1966. Pursuant to the leases, Swank was authorized to mine coal on lands owned by the county in exchange for a royalty of 35 cents per gross ton of coal removed. Swank could sell the coal to whomever he pleased at whatever price he could obtain. Both leases contained provisions for automatic termination if either (1) the County sold the lands; (2) the tax delinquent former owners redeemed the lands; (3) the lessee failed to mine and remove coal for 30 consecutive days absent abnormal conditions; or (4) the lessee failed to comply with the terms of the lease agreement. Moreover, each lease provided, in accordance with the County's practice with respect to all leases negotiated between January 1, 1956 and May 31, 1969, that the lessor could "terminate this agreement completely and fully without liability upon it or any further recourse against it, upon thirty days written notice given to MINER * * *."[2] On his 1966 and 1967 federal income tax

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[1] References to Swank are to respondent Elwood Swank. Rita Swank is a party solely because she filed joint federal income tax returns with her husband for the years in issue.

[2] The Court of Claims found that it had been the publicly announced policy from 1956 that the Northumberland County Commissioners would not terminate a mining lease except

returns, Swank claimed a deduction for depletion of coal resources covered by the leases with the County of Northumberland (App. A, *infra*, 11a-12a; Finding Nos. 2, 3, 6, 8-12, 14).

b. *Black Hawk Coal Corporation.* During 1970-1972, respondent Black Hawk Coal Corporation was engaged in the mining of coal on lands located in Pike County, Kentucky. The lands in question were under a lease agreement dated February 20, 1964, between Kentland Coal & Coke Company, Division of the Berwind-White Coal Mining Company, as lessor, and Eugene M. Bane, as lessee. Bane in turn assigned the lease to respondent. Pursuant to the terms of that agreement, respondent, as lessee, was authorized to remove coal from specified lands for an unspecified term until the coal seam was exhausted, for a consideration of $5,000 per year, payable monthly, plus 25 cents per ton of coal removed. The latter amount was to be credited against the monthly royalty as rental. The lease agreement was terminable if respondent failed to pay the required rent or royalties for a period of 60 days after the due date of such payments, and was cancellable by either party without cause on 30 days' written notice. The agreement permitted respondent to sell the coal which it mined to anyone. On its federal income tax returns for 1970-1972, respondent claimed a percentage de-

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for cause because of the time and capital which a lessee would be expected to invest in mining operations. However, the Commissioners would not give any assurance that they could not cancel a lease without cause (Finding No. 15).

pletion deduction with respect to the coal which had been mined under the lease agreement (Stip. paras. 3, 6, 8, 10; Stip. Ex. 4, at 3).

c. *Bull Run Mining Co.* During its taxable year ended September 30, 1974, respondent Bull Run Mining Co., Inc. was engaged in mining coal in West Virginia, under a lease agreement, dated June 21, 1967, between it, as lessee, and Preston County Coal and Coke Corporation, as lessor. The lease was for a five-year term, which was thereafter extended for an additional five years. Pursuant to the terms of the lease, respondent was authorized to mine coal on specified lands for the payment of a monthly royalty of 25 cents per ton of coal removed. The lease agreement was cancellable by either party on 30 days' written notice. The lease gave the lessor the first opportunity to buy the coal mined by respondent at the current market price. The lessor exercised this right so that respondent sold all of the coal it mined during 1974 to the lessor. On its federal income tax return for its taxable year ended September 30, 1974, respondent claimed a depletion deduction with respect to the coal which it mined as lessee under the agreement (Bull Run Pet. paras. 3, 5; Bull Run Pet. Ex. A).

2. On audit of each of respondents, the Commissioner of Internal Revenue determined deficiencies in income taxes on the ground that none of them possessed a depletable economic interest in the minerals covered by the leases under which they were lessees. The Commissioner therefore disallowed respondents' claimed depletion deductions for the taxable years at

issue. After respondents paid the resulting assessments, they filed claims for refund, which the Commissioner denied. Respondents thereupon instituted these refund suits in the Court of Claims (App. A, *infra*, 3a). (Swank—Findings Nos. 4-5; Black Hawk Stip. paras. 11-14; Bull Run Mining Co.—Findings Nos. 10-13).

The Court of Claims consolidated all three cases for argument. It upheld respondents' claims for refund on the authority of its prior decision in *Bakertown Coal Co.* v. *United States*, 485 F.2d 633 (1973). There, on virtually identical facts, a divided en banc court held that lessees under comparable coal leases had an economic interest in the coal in place, thereby entitling them to the percentage depletion deduction for the coal mined. The Court of Claims adhered to its *Bakertown* decision, ruling that the fact that the lessors could have terminated the lease without cause did not deprive respondent lessees of an economic interest in the minerals in place and the depletion deduction (App. A, *infra*, 1a-10a). As the court saw the matter, "the mere existence of the unused termination clause is not enough to deprive the taxpayer-lessees of their 'economic interest' they would otherwise admittedly have" (App. A, *infra*, 5a). In so holding, the court acknowledged that its decision squarely conflicted with *Whitmer* v. *Commissioner*, 443 F.2d 170 (3d Cir. 1971) (App. A, *infra*, 5a-6a).

The Court of Claims further observed that even on the assumption that the lessor's legal right to terminate the lease (rather than whether there was an

actual termination) was determinative of the lessee's eligibility to the depletion deduction, it "[could] not say *a priori* [in the absence of any proof] that a month's period is too short for a miner to expect to extract a substantial amount of coal" (App. A, *infra*, 8a). In considering the effect of a termination clause, the court therefore concluded that "[l]ike *Bakertown*, these cases do not involve leases terminable within a single day" (*ibid.*).

Finally, as in *Bakertown* (see 485 F.2d at 642), the Court of Claims found persuasive the fact that if respondents' claimed depletion deductions were disallowed, there would be no depletion on the coal mined under these leases. Although the court acknowledged the correctness of the government's argument that every applicant for the depletion allowance must show his own entitlement, it nevertheless concluded "that Congress, in establishing percentage depletion, intended that, except for extraordinary instances, someone should be entitled to depletion on all mined coal covered by the Code provision. Cf. I.R.C. § 613(c)" (App. A, *infra*, 9a). As the court observed, "[w]here there can be no other claimant, we believe that neither the Internal Revenue Service nor the courts should be too technical or too harsh in finding the only possible applicant to be ineligible. The considerations are in some (though of course not all) respects different from the cases in which a choice has to be made among competing claimants" (*ibid.*).

REASONS FOR GRANTING THE PETITION

1. In holding that a provision in a mineral lease permitting the lessor to terminate the lease on 30 days' notice without cause did not defeat the lessee's claim to a depletion deduction, the Court of Claims both here (App. A, *infra*, 5a-6a) and in its previous opinion in *Bakertown Coal Co.* v. *United States*, 485 F.2d 633, 640-641 (1973), acknowledged that its decision squarely conflicted with *Whitmer* v. *Commissioner*, 443 F.2d 170 (3d Cir. 1971). There, on identical facts, the Third Circuit rejected the lessee's claimed depletion deduction, observing that "[s]uch right on the part of the lessor to terminate would appear to be fatal to a lessee's ability to claim the depletion deduction because no right to extract until exhaustion of the coal has been granted" (443 F.2d at 173). Accord: *Costantino* v. *Commissioner*, 445 F.2d 405, 409 (3d Cir. 1971) (30-day termination); *Mullins* v. *Commissioner*, 48 T.C. 571 (1967) (60-day termination); *Winters Coal Co.* v. *Commissioner*, 57 T.C. 249 (1971) (30 and 60-day termination), rev'd on other grounds, 496 F.2d 995 (5th Cir. 1974); *Holbrook* v. *Commissioner*, 65 T.C. 415 (1975) (30-day termination); *Weaver* v. *Commissioner*, 72 T.C. 594, 606-609 (1979) (immediate termination); Rev. Rul. 77-481, 1977-2 Cum. Bull. 205.

Similarly, in conformity with this Court's decisions in *Parsons* v. *Smith*, 359 U.S. 215, 224-225 (1959), and *Paragon Jewel Coal Co.* v. *Commissioner*, 380 U.S. 624, 633 (1965), both the Fourth and Fifth Circuits have expressed the view that the lessor's

right to terminate a mineral lease on short notice is a significant factor in determining the lessee's entitlement to a depletion deduction. *United States* v. *Stallard*, 273 F.2d 847 (4th Cir. 1959); *McCall* v. *Commissioner*, 312 F.2d 699 (4th Cir. 1963); *United States* v. *Wade*, 381 F.2d 345 (5th Cir. 1967). See also *Ramey* v. *Commissioner*, 47 T.C. 363, 375 (1967), aff'd, 398 F.2d 478 (6th Cir. 1968); *Usibelli* v. *Commissioner*, 229 F.2d 539 (9th Cir. 1955); *Rissler & McMurry Co.* v. *United States*, 480 F.2d 684 (10th Cir. 1973).

Moreover, since the Court of Claims' prior decision in *Bakertown Coal Co.*,[3] the effect of a short notice termination clause in a mineral lease upon the lessee's entitlement to the depletion deduction has assumed greater administrative importance. We are advised by the Internal Revenue Service that there are currently 15 cases pending administratively either on audit or at the appellate level, or in the district courts, with approximately $2,176,383 of revenue at stake. Since the Service has announced that it will not follow *Bakertown Coal Co.* (see Rev. Rul. 77-481, *supra*), the impact of the decision below upon the revenue can be expected to increase. This Court should now put to rest the uncertainty engendered by the conflict of decisions and establish a uniform rule to guide both the Internal Revenue Service and those who enter into mineral leasing arrangements.

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[3] We did not petition for a writ of certiorari in *Bakertown* because of doubt at that time whether the decision would have sufficient continuing importance to warrant this Court's review.

2. Section 611(a) of the Code (App. C, *infra*, 23a) provides that "[i]n the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion * * * according to the peculiar conditions in each case * * *." As this Court has declared many times, the depletion deduction "is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production." *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366 (1938). Thus, the deduction is "designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 312 (1956). "In short, the purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset." *Parsons* v. *Smith*, 359 U.S. 215, 220 (1959).[4]

In response to the variety of financial arrangements employed in the extraction of minerals, this Court almost 50 years ago in *Palmer* v. *Bender*, 287 U.S.

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[4] Pursuant to Treasury Regulations, Section 1.611-1(a)(1) (App. C, *infra*, 24a), the depletion deduction is computed on the basis of cost (Section 612) or upon the basis of a specified percentage of the gross income from the property (Section 613), whichever results in the greater allowance for any taxable year. Section 613(b)(4) permits a percentage depletion deduction of ten percent with respect to coal.

551 (1933), developed the "economic interest" test for determining what interests in mineral deposits were permitted a depletion deduction under the practically identical statutory predecessors of Sections 611 and 613. As the Court there stated, "[t]he language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital." The Court further said that the deduction is not "dependent upon the particular legal form of the taxpayer's interest in the property to be depleted, [and that] [i]t is enough if * * * he has retained a right to share in the oil produced. If so he has an *economic interest* in the oil, in place, which is depleted by production" (emphasis added) (287 U.S. at 557). Accord: Treasury Regulations, Section 1.611-1(b)(1) (26 C.F.R.) (App. C, *infra*, 24a).

Subsequently, in *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362 (1938), the Court refined the "economic interest" concept. It observed that "* * * the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit" (*id.* at 367). Applying that principle to the facts of that case, the Court held that a processor who acquired the right to take gas from the wellheads and to extract and sell gasoline therefrom, paying the well

owners a percentage of the proceeds of such sales, had not acquired an economic interest in the depleting gas in place but only an economic advantage to be derived from the processing operations, so that the processor was not eligible for the depletion deduction.

The decision of the Court of Claims in the instant case, and in *Bakertown Coal Co.* to which it adhered (App. A, *infra*, 5a), reflects a fundamental misconception of this Court's "economic interest" test. As we have pointed out (*supra*, pages 10-11), a taxpayer claiming a depletion deduction must have an economic interest in the minerals in place. But given the lessor's right to terminate the leases in these cases on 30 days' notice, without cause, it is difficult to imagine what kind of "economic interest" respondents could be said to have acquired in the minerals in place. Respondents' right to mine the coal was completely subject to the will of their lessors who could have forced them to abandon their ventures on short notice if the lessors found the leases to be unprofitable or disadvantageous in light of changing market conditions. In these circumstances, it is the lessors who have the economic interest in the coal in place, and respondents cannot claim a right to exhaust either the entire coal deposits, or any particular substantial part of it. See G.C.M. 26290, 1950-1 Cum. Bull. 42, declared obsolete, Rev. Rul. 70-277, 1970-1 Cum. Bull. 280. Respondents' mining rights were entirely subordinate to the lessors' right to terminate the arrangement at will, on 30 days' notice. As the Third Circuit observed in *Whitmer* v. *Commissioner*, *supra*, 443

F.2d at 173, "[s]uch right on the part of the lessor to terminate would appear to be fatal to a lessee's ability to claim the depletion deduction because no right to extract until exhaustion of the coal has been granted."

Moreover, the analysis of the Third Circuit in *Whitmer* is entirely in accord with this Court's appraisal of the effect of the lessor's right to terminate on short notice upon the lessee's entitlement to a depletion deduction. Thus, in *Parsons* v. *Smith*, *supra*, this Court affirmed two decisions of the Third Circuit (255 F.2d at 595; *id.* at 597) disallowing the lessees' claimed depletion deductions where "the contracts were completely terminable without cause on short notice" (359 U.S. at 225). In so holding, the Court necessarily rejected the view of the dissenting judge in the court of appeals (upon that court's denial of rehearing en banc) that "the right of termination does not affect a stripper's right to depletion where the requisite economic interest as defined by the Supreme Court exists" (255 F.2d at 602). See also *Paragon Jewel Coal Co.* v. *Commissioner*, 380 U.S. 624, 634-636 (1965).

3. a. In *Bakertown Coal Co.* v. *United States*, *supra*, the Court of Claims acknowledged that this Court in *Parsons* v. *Smith*, *supra*, accorded significant weight to the lessor's right to terminate on short notice without cause in ruling that the lessee was thereby deprived of an economic interest in the minerals in place. However, the Court of Claims refused to ascribe controlling weight to the lessor's right to terminate at will. As it saw the matter, "[t]hough

terminability was one of the seven disqualifying factors mentioned [in *Parsons* v. *Smith*, *supra*], it cannot be considered either in isolation or in the abstract, as the Government would have it" (485 F.2d at 639). In the Court of Claims' view, "the matter of terminability becomes only a colorably relevant factor where the applicant for the allowance lacks the traditional qualifications for depletion, as reflected by the other six conditions referenced by the court" (*ibid.*).[5] The Court of Claims therefore distinguished *Parsons* v. *Smith*, *supra*, on the ground that there "the coal

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[5] In *Parsons* v. *Smith*, *supra*, 359 U.S. at 215, the Court enumerated seven factors in support of its decision rejecting miners' contractors' claims to depletion deductions. The Court cited the facts (*id.* at 225)—

> (1) that petitioners' investments were in their equipment, all of which was movable—not in the coal in place; (2) that their investments in equipment were recoverable through depreciation—not depletion; (3) that the contracts were completely terminable without cause on short notice; (4) that the landowners did not agree to surrender and did not actually surrender to petitioners any capital interest in the coal in place; (5) that the coal at all times, even after it was mined, belonged entirely to the landowners, and that petitioners could not sell or keep any of it but were required to deliver all that they mined to the landowners; (6) that petitioners were not to have any part of the proceeds of the sale of the coal, but, on the contrary, they were to be paid a fixed sum for each ton mined and delivered, which was, as stated in *Huss*, agreed to be in "full compensation for the full performance of all work and for the furnishing of all [labor] and equipment required for the work"; and (7) that petitioners, thus, agreed to look only to the landowners for all sums to become due them under their contracts.

company was bound to pay the contractors the posted fee regardless of the condition of the market at the time of delivery and, thus, that the contractors did not look to the sale of the coal for a return of their investment but looked solely to the coal company" (485 F.2d at 640).

To be sure, the Court of Claims correctly concluded that the mining contractors in *Parsons* v. *Smith*, *supra*, "were equally deficient under each of the six other criteria set forth by the Supreme Court." See also *Paragon Jewel Coal Co.* v. *Commissioner*, *supra*; *United States* v. *Stallard*, *supra*; *McCall* v. *Commissioner*, *supra*. But this purported distinction ignores this Court's admonition, made in the context of another depletion case, that "the tax law deals in economic realities, not legal abstractions." *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 315 (1956). If the market price of the minerals rises above the lessor's royalty, the lessor will assuredly exercise his right to terminate the lease on short notice and will either enter into a more profitable lease or extract the mineral himself and sell it. In these circumstances, the terminability on short notice [6] gives the

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[6] The Court of Claims also held that, even if the lessor's right to terminate the lease were determinative, the court could not say, in the absence of proof, that 30 days was too short a period for the lessee to extract a substantial amount of coal (App. A, *infra*, 8a). But this refund suit is analogous to an action for money had and received. Hence, respondents bore the burden of proof that they overpaid their taxes and were entitled to a refund of a particular amount. *Lewis* v. *Reynolds*, 284 U.S. 281 (1932). The absence of proof should therefore redound to respondents' detriment, and not to the

lessor the powerful right to assume complete and unfettered dominion over the mineral deposit, *viz.*, an economic interest in the minerals in place. The unexercised termination clause therefore has profound economic significance, rather than, as the decision below erroneously concluded (App. A, *infra*, 5a), "mere existence."

b. Finally, there is no basis for the Court of Claims' observation, made both in the instant case (App. A, *infra*, 9a) and in *Bakertown Coal Co.* v. *United States*, *supra*, 485 F.2d at 642, that if respondents are not entitled to the depletion deduction, "there will be no depletion on the coal mined under these leases" (App. A, *infra*, 9a). The court apparently believed this conclusion to follow from the fact that "[u]nder the express terms of Section 631(c) of the 1954 Code, the lessors are 'relegated to capital gains treatment of the royalties received' *Paragon Jewel Coal Co.* v. *Commissioner*, *supra*, 380 U.S. at 636 * * *" (485 F.2d at 642).

But the capital gains treatment to which the lessors would be entitled under Section 631(c) does not deprive them of the benefits of depletion, which "is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." *Commissioner* v. *Southwest Exploration Co.*, *supra*,

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government's. At all events, the question is not whether respondents could extract a substantial amount of coal in 30 days, but whether they could extract a substantial portion of the deposits in that period. See G.C.M. 26230, *supra*.

350 U.S. at 312. The special capital gains rule of Section 631(c) applies only when the "owner retains an economic interest in such coal * * *." In these circumstances, the owner fully recoups his capital investment in the minerals and thereby obtains the benefits of depletion by measuring his gain by "the difference between the amount realized from the disposal of such coal * * * and the adjusted depletion basis thereof * * *." While the lessor will not ratably recover his basis through percentage depletion, the subtraction of his adjusted depletion basis in measuring his gain insures that he will "make a tax-free recovery of that depleting capital asset" (*Parsons* v. *Smith*, *supra*, 359 U.S. at 220) under the cost depletion method (Section 612). See *Herring* v. *Commissioner*, 293 U.S. 322, 327-328 (1934). Accordingly, the lessor and not the lessee is entitled to the depletion deduction.

As matters now stand, it is plain that if the conflict between the Court of Claims and the Third Circuit persists, the parties to mineral leases will continue to be uncertain as to who has the economic interest in the minerals in place and obtains the benefits of the depletion deduction. Since the consideration for such arrangements rests in large part upon their tax consequences, fairness to both lessors and lessees requires a settled rule governing these leases that would guide their negotiations and be binding on the Internal Revenue Service. Review by this Court is therefore warranted.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MARCH 1980

APPENDIX A

IN THE UNITED STATES COURT OF CLAIMS

(Decided July 18, 1979)

No. 403-75

ELWOOD SWANK AND RITA SWANK

v.

THE UNITED STATES

Lloyd R. Persun, attorney of record, for plaintiffs. *Howell C. Mette* and *Shearer, Mette & Woodside*, of counsel.

James L. Malone, III, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser* and *Robert S. Watkins*, of counsel.

ON DEFENDANT'S EXCEPTIONS TO THE TRIAL JUDGE'S DECISION

No. 49-77

BLACK HAWK COAL CORPORATION, INC.

v.

THE UNITED STATES

LeRoy Katz, attorney of record, for plaintiff. *Katz, Kantor, Katz, Perkins & Cameron*, and *Richard L. Hirshberg*, of counsel.

James L. Malone, III, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser, Robert S. Watkins* and *Judith H. Johnson*, of counsel.

ON STIPULATION OF FACTS

No. 400-77

BULL RUN MINING CO., INC.

v.

THE UNITED STATES

Woodrow A. Potesta, attorney of record, for plaintiff.

James L. Malone, III, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser, Robert S. Watkins* and *Jo-Ann Horn*, of counsel.

ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND DEFENDANT'S CROSS MOTION FOR SUMMARY JUDGMENT

Before DAVIS, KASHIWA, and BENNETT, *Judges*.

PER CURIAM: These three tax refund suits, consolidated for argument, all present the single question of whether a provision in a coal-mining lease permitting termination by either party (or by the lessor alone) on 30 days' notice precludes the plaintiff-lessees from having an "economic interest" in the coal in place which would entitle them to a percentage allowance for depletion under sections 611 and 613 of the Internal Revenue Code of 1954. The Government admits that, in the absence of this 30-day termination provision, the lessees would all be entitled to such a depletion allowance.[1]

Though they all involve the single issue we have stated, the cases come before the court in different ways and concern different tax years. No. 403-75, involving 1966 and 1967, was tried before Trial Judge Bernhardt who has rendered his decision that plaintiffs are entitled to recover. No. 49-77, involving 1970-1972, is before us on a stipulation of facts. No. 400-77, involving fiscal 1974, comes to us on cross-motions for summary judgment. It is unnecessary to

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[1] In No. 403-75, there was a slight suggestion by the defendant in its briefs that in any event the particular terms of those leases precluded those plaintiffs from having a sufficient "economic interest" (apart from the termination clause), but, on inquiry, this contention was not pressed at the oral argument—and in any case we reject it.

set forth here the individual facts because for present purposes the cases are legally all the same.[2]

Each taxpayer held a lease (or leases) of coal-bearing property with unstated duration or duration for a term of years—subject to the termination clause or clauses. These leases provided for royalties (plus, in at least one of the cases, a flat annual rent) to be paid by the lessee [3] and gave him the right to extract coal and to sell it to whomever and at whatever price he chose.[4] Each lease contained a clause permitting either party (or the lessor alone) to terminate the lease (and operations thereunder), apparently without cause, within thirty days. In each case the plaintiffs mined coal under these leases during the taxable years and for a substantial time before. The proceeds from the sales of the coal represented the sole source of revenue from which the lessees could recover any rents and royalties paid to the lessor for the right to mine.

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[2] In No. 403-75 the court adopts the trial judge's findings of fact though they are not printed herewith. In No. 49-77 we adopt the parties' stipulation of facts as the court's findings of fact. In No. 400-77 the relevant facts are not in dispute and this opinion reflects such facts as are necessary to sustain our disposition of the cross-motions for summary judgment.

[3] The rents and royalties were not tied to the prices received by the lessees from the coal.

[4] In No. 400-77, the lessor had the right of first purchase but only if it met plaintiff-lessee's price. The lessee could always sell to another at a price higher than the lessor was willing to pay.

On these facts, as defendant recognizes (and as Trial Judge Bernhardt held in No. 403-75), the cases are each governed by our decision in *Bakertown Coal Co.* v. *United States*, 202 Ct. Cl. 842, 485 F.2d 633 (1973), which presented the identical issue on facts practically the same as those now before us. This panel cannot, under this court's practice, depart from that holding. *See Dravo Corp.* v. *United States*, 219 Ct. Cl. —— (slip op. at 2), 594 F.2d 842, 843 (1979). Nor have we been persuaded that *Bakertown* was wrongly decided or that we should ask the court *en banc* to reconsider the issue.[5]

The Government picks at this or that aspect of the *Bakertown* opinion, but the core holding of that case remains—that coal-mining lessees with leases like those in *Bakertown* (and in these cases) have an "economic interest" in the coal, entitling them to percentage depletion for the coal mined during the taxable years, even though those leases could theoretically and legally have been terminated by the lessor, without cause, on 30 days' notice; the mere existence of the unused termination clause is not enough to deprive the taxpayer-lessees of their "economic interest" they would otherwise admittedly have. Except for *Whitmer* v. *Commissioner*, 443 F.2d 170 (3rd Cir. 1971)—with which the *Bakertown* court expressly

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[5] It has some significance to us that, since *Bakertown*, the Treasury Department has not modified the relevant regulation which continues to speak only in very general terms so as to exclude from the depletion deduction terminable leases like those involved here.

disagreed—we know of no Supreme Court or Court of Appeals holding in conflict with this ruling of *Bakertown.*

Defendant says that *Bakertown* over-stressed the difference between true coal-lessees and coal contract-miners, and that the name or legal form of the mining arrangement is immaterial in determining "economic interest." We are told that what is important in appraising whether the taxpayer has acquired by investment such an interest in the coal in place is whether that taxpayer has, and can have, an adequate expectation at the beginning of the arrangement (or perhaps of the taxable year) that he will be permitted to mine to exhaustion or at least to mine a substantial amount of the coal,[6] and therefore will be able to appraise both his interest in the coal in place and what portion of that interest he has extracted during the taxable period. This need for advance calculation follows, defendant says, from the historical fact that percentage depletion was introduced as a substitute method of calculation for discovery depletion; on the Government's premise, in all the methods of depletion the taxpayer, to be entitled to the deduction, has to be able to estimate in advance his full interest in the minerals in place so that he can determine (at least roughly) what part he has actually taken out of the ground during the particular

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[6] GCM 26290, 1950-1 CUM. BULL. 42, considers this expectation to be solid enough where the contract cannot be terminated without cause within less than one year.

period. With the 30-day cancellation clause, the argument goes, the coal miner or lessee cannot make such an advance estimate because he has and can have no such expectation beyond a month's time.

Even were we to accept defendant's premise that leases are no different for our purposes from mere contract mining arrangements, we could not deny depletion to the present taxpayers. For the records in these cases (as in *Bakertown*) show that each of the taxpayers had regularly mined coal from the leases in question for a very substantial period prior to the taxable years[7] and that, in all reality, they had a very good expectation of being able to continue to do so. In Nos. 403-75 and 400-77, we accept the showing that the lessors rarely (if ever) terminated without cause, not as demonstrating that the lessors lacked the legal power to terminate without cause,[8] but solely as showing that in practice and in reality the plaintiff coal-lessees had, at all relevant times, a solid expectation that they could continue under their leases to mine the coal for a substantial period and to extract a substantial amount of the coal.[9] This means—

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[7] In each instance more than the one-year period cited as sufficient in GCM 26290, *supra*, note 6.

[8] In No. 403-75 plaintiffs' claim to the judges that the leases could only be terminated for cause is precluded by the trial judge's findings that no such assurance was ever given, and that the reasonable interpretation of the termination clause permitted termination without cause. Plaintiffs failed to except to those findings.

[9] We were told at oral argument by counsel for one of the plaintiffs that lessors have not terminated, even though the

unless we are to depart from defendant's own norm for testing "economic interest" by substance and reality, rather than by mere nomenclature or the theoretical form of the legal arrangement—that taxpayers are entitled to depletion. They satisfy the proffered criterion of knowing in advance that they will be able to mine for a substantial period and to extract a substantial portion of the coal. Certainly this was true at the beginning of each of the taxable years.

If, however, we must look (contrary to the theme of the Government's presentation) only to the theoretical and legal right of the lessor to cancel within 30 days as if there was such a real possibility every month.[10] We cannot say *a priori* that a month's period is too short for a miner to expect to extract a substantial amount of coal. There is no such proof before us and we do not believe it is a matter of judicial notice. Like *Bakertown*, these cases do not involve leases terminable within a single day.

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value of coal has increased markedly in the recent past and the royalties fixed in the leases now seem "outdated," because, for a new lessee, the costs of continuing with an existing mine are usually so great, comparatively, that it is difficult for a lessor to obtain new lessees at terms more favorable to the lessors than the existing leases. We do not accept this as evidence, but the record contains nothing to contradict this explanation for what seems to be the fact that leases of this type have not been regularly cancelled by lessors in recent years.

[10] And if contrary to *Bakertown*, that termination right were all-important and all-determinative even in the case of a true lease.

Finally, we reiterate what was said in *Bakertown*, 202 Ct. Cl. at 857, 485 F.2d at 642, about the non-availability in these cases of the depletion allowance to the lessors or anyone else. If plaintiffs are not entitled, there will be no depletion on the coal mined under these leases. The Government insists that every applicant for the allowance must show his own entitlement. We agree, but think that Congress, in establishing percentage depletion, intended that, except for extraordinary instances, someone should be entitled to depletion on all mined coal covered by the Code provision. *Cf.* I.R.C. § 613(c). Where there can be no other claimant, we believe that neither the Internal Revenue Service nor the courts should be too technical or too harsh in finding the only possible applicant to be ineligible. The considerations are in some (though of course not all) respects different from the cases in which a choice has to be made among competing claimants.

Conclusion

For these reasons, we conclude as follows:

(a) In No. 403-75, we adopt the trial judge's opinion (and set it forth *infra*) and his findings, and on that basis, as well as on the foregoing *per curiam* opinion, we hold that plaintiffs are entitled to recover taxes and interest assessed, plus interest as provided by law.

(b) In No. 49-77, on the basis of the stipulated facts and the foregoing *per curiam* opinion, we hold

that plaintiff is entitled to recover taxes and interest assessed, plus interest as provided by law.

(c) In No. 400-77, we grant plaintiff's motion for summary judgment and deny defendant's cross-motion, for summary judgment, and hold that plaintiff is entitled to recover interest and taxes assessed, plus interest as provided by law.

(d) In each case, the amount of recovery will be determined pursuant to Rule 131(c).

OPINION OF TRIAL JUDGE IN NO. 403-75

BERNHARDT, *Trial Judge*: In *Bakertown Coal Co.* v. *United States*, 202 Ct. Cl. 842, 485 F.2d 633 (1973), the court held, contrary to the sense of *Whitmer* v. *Commissioner*, 28 T.C.M. (CCH) 1480 (1969), *aff'd*, 443 F.2d 170 (3d Cir. 1971), that a lessee of coal-bearing property whose lease provided a bilateral 30-day termination notice and a tonnage royalty for rent, and allowed a vesting of ownership by the lessee in the coal as mined with the right to extract and sell it to whomever and at whatever price he chose, acquired an economic interest in the coal in place sufficient to earn a depletion deduction under Section 611(a) of the Internal Revenue Code of 1954, *as amended*. Despite the virtual identity of the facts in the present case with those in *Whitmer*, which held against the taxpayer, there is such comparability in significant legal principle to this court's opinion in *Bakertown* that a judgment for the plaintiff tax-

payer [1] is required. Conflict between *Bakertown* and *Whitmer* is basic. The Tax Court has been consistent. See *Mullins* v. *Commissioner*, 48 T.C. 571 (1967), and *Winters Coal Co.* v. *Commissioner*, 57 T.C. 249 (1971). More recently *Bakertown* was followed in *Thornberry Constr. Co.* v. *United States*, 217 Ct. Cl. , 576 F.2d 346 (1978), so this court has also been consistent in its difference.

During 1966 and part of 1967 the plaintiff, an independent coal mine operator, leased from Northumberland County, Pennsylvania, and mined coal from, two properties of which, *inter alia*, the county had acquired title at sales for delinquent taxes. The leases, which were on a standard form in use by the county for a number of years, and were for an unstated duration until termination, provided for the payment of 35¢ per ton royalties, for termination by the county on specified grounds, and for termination by the county without cause on 30 days written notice. Both plaintiff and a representative of the county testified, over defendant's objection, that the county had never—and would not—terminate a coal lease without cause. One of the properties had been leased previously by the county to one Gusick, to whom plaintiff paid $12,085 for equipment and an existing excavation, and the other was a strip mining operation on land which had not been previously worked. Plaintiff paid $6,500 to construct an access road to

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[1] The term "plaintiff" shall refer to both husband and wife as an entity.

the strip mine. A third property had also been leased by plaintiff from the county for deep mining, also succeeding a prior lessee to whom plaintiff had paid money for equipment and an excavation, but plaintiff never extracted any coal pursuant to the deep mining lease because he did not have the miners to operate the mine, so the lease was terminated for this failure in November 1969. Plaintiff had paid $118,477.27 for the acquisition and improvement of a tipple [2] from 1959 to 1966. In 1962 or 1963 he had paid $10,000 for a railroad siding near the breaker. He had also purchased $373,123.83 worth of equipment for use in his mining operations, but there is no way of allocating this cost between plaintiff's mining business and a trucking business which he also had, nor of allocating the cost to the two mines in suit is distinguished from its use in the processing of coal purchased from other mines. Plaintiff paid Northumberland County royalties in 1966 and 1967 for production of coal from the two leased mines which he operated, and sold the excavated coal to buyers of his choice and at prices he fixed. He claimed deductions in his 1966 and 1967 income tax returns for depletion of his economic interest in the coal in place under his two leases. Upon disallowance of the deductions by the IRS plaintiff paid tax deficiencies of $30,586.84 under protest, together with interest of $3,663, which he now seeks to recover.

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[2] A device for breaking, cleaning, and sorting coal, located within convenient distance from the mines.

Section 611(a) of the Code authorizes "a reasonable allowance for depletion" of mineral deposits under regulations prescribed by the Secretary. Treas. Reg. § 1.611-1(b) (1970) limits the depletion deduction to the owner of an economic interest in the mineral in place acquired by capital investment, and distinguishes a depletable economic interest from a mere economic or pecuniary advanatge such as a contract right to purchase the mineral product from the owner of an economic interest, or the right to compensation for services in extracting minerals.

The defendant labors the false issue of parol evidence admitted at trial over objection to show that for over a decade it was the unbroken practice of Northumberland County to terminate its coal leases only for cause, the clear term of the standard lease form to the contrary notwithstanding. Under the identical lease form in *Whitmer, supra,* the Tax Court —seemingly without demur from defendant—received much the same parol evidence that was offered and received here, and nevertheless held that the express provision of the lease as to short termination notice precluded an economic interest by the lessee in the coal in place. On appeal the Circuit Court held the parol evidence inadmissible. 443 F.2d at 173. *Bakertown* which involved no such parol evidence, held that the lessee's property interest "is not varied or diminished simply because the authority is subject to the possibility of extinction in the future by a termination of the leases on short notice." *Bakertown, supra,* 202 Ct. Cl. at 847-48, 485 F.2d at 636.

While, because of *Bakertown*, the immediate case does not require consideration of the parol evidence that was received, it should be observed in passing that the rule that parol evidence cannot be admitted to vary, explain, or contradict a writing is available primarily to the parties to the writing and not to a stranger, such as the government in this instance. 30 AM. JUR. 2d §§ 1029-31; 3 A. CORBIN ON CONTRACTS, § 596 (1960 ed.); *Mustard* v. *United States*, 140 Ct. Cl. 205, 216, 155 F. Supp. 325, 332 (1957); *Smith* v. *Commissioner*, 324 F.2d 725, 726 (9th Cir. 1963); *Thorsness* v. *United States*, 260 F.2d 341, 345 (7th Cir. 1958).

Since the nature of "economic interest" was expounded in *Palmer* v. *Bender*, 287 U.S. 551 (1933), it has become commonplace in tax opinions. *Filtrol Corp.* v. *United States*, 203 Ct. Cl. 32, 35, 487 F.2d 536, 538 (1973). *Palmer* limits the right to depletion to the taxpayer who "has acquired, by investment, any interest in the oil in place", and who "secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital." *Id.*, 287 U.S. at 557. The economic interest of the lessee exists independent of the lessor's legal title to the oil [or other mineral] in place. *Lynch* v. *Alworth-Stephens Co.*, 267 U.S. 364 (1925); *National Steel Corp.* v. *United States*, 176 Ct. Cl. 952, 966, 364 F.2d 375, 382-83 (1966). The taxpayer's investment in depreciable equipment is not a factor in the concept of a depletable eco-

nomic interest in the coal. *Parsons* v. *Smith*, 359 U.S. 215 (1959). The lessee's right under his lease to convert the lessor's legal title to minerals in place to his own possession by their severance constitutes a very real economic interest in the mineral in place which depletes as the minerals are extracted. To exemplify by contrast, a lessee who, as a mining contract rather than a mine operator, contracts for compensation to extract minerals for the lessor, acquires no economic interest in the minerals in place, and hence cannot claim a depletion deduction. *Parsons* v. *Smith, supra; Paragon Jewel Coal Co.* v. *Commissioner*, 380 U.S. 624 (1965); *United States* v. *Stallard*, 273 F.2d 847 (4th Cir. 1959); *McCall* v. *Commissioner*, 312 F.2d 699 (4th Cir. 1963); *United States* v. *Wade*, 381 F.2d 345 (5th Cir. 1967).

The dissent in *Bakertown, supra*, 202 Ct. Cl. at 859, 485 F.2d at 643, suggests that plaintiff could not have had an economic interest if the lessor could terminate at will whenever the market price of coal increased. *Bakertown* involved a private lessor, whereas in the instant case the lessor is Northumberland County, a governmental entity which, unlike a private owner, was interested more in insuring that its coal lands were being actively mined than in the amount of income obtained. As proof of this interest the county never changed the royalty fee in its leases from 1956 through May 31, 1969. Plaintiff knew this.

In *Thornberry Constr. Co.* v. *United States, supra,* the coal mining lease required the lessee to first offer the mined coal to a third party on pain of termination, but left the price to be set by the lessee and permitted it to sell to others after the third party's requirements were met. Independent of the fact that termination was only for cause, this court held that the lessee had a depletable economic interest because, as in *Palmer, supra,* it looked solely to the income derived from the extraction of coal for a return of its capital.

Defendant's denial of a depletion allowance was erroneous. Plaintiff is entitled to recover taxes and interest assessed because of the erroneous denial, plus interest as provided by law. The amount of plaintiff's recovery should be determined pursuant to Rule 131(c)(2).

APPENDIX B

IN THE UNITED STATES COURT OF CLAIMS

No. 403-75

[Filed Nov. 30, 1979]

ELWOOD SWANK AND RITA SWANK

v.

THE UNITED STATES

ORDER

On July 18, 1979, the court rendered an opinion holding that the plaintiffs were entitled to recover and entering judgment to that effect. The determination of the amount of recovery was reserved pending further proceedings pursuant to Rule 131(c)(2).

On November 26, 1979, the trial judge of this court filed a memorandum report recommending that, in accordance with the opinion of the court and the stipulation of the parties, judgment be entered for the plaintiffs of $35,806.07, plus statutory interest, which recommendation is adopted by the court.

IT IS THEREFORE ORDERED that judgment be and the same is entered for the plaintiffs of thirty-

five thousand eight hundred six dollars and seven cents ($35,806.07), plus statutory interest.

BY THE COURT

/s/ Daniel M. Friedman
DANIEL M. FRIEDMAN
Chief Judge

IN THE UNITED STATES COURT OF CLAIMS

No. 49-77

[Filed Dec. 7, 1979]

BLACK HAWK COAL CORPORATION, INC.

v.

THE UNITED STATES

ORDER

On July 18, 1979, the court rendered an opinion holding that the plaintiff was entitled to recover and entering judgment to that effect. The determination of the amount of recovery was reserved pending further proceedings pursuant to Rule 131(c)(2).

On December 4, 1979, the trial judge of this court filed a memorandum report recommending that, in accordance with the opinion of the court and the stipulation of the parties, judgment be entered for the plaintiff of $164,141.03, plus statutory interest, which recommendation is adopted by the court.

IT IS THEREFORE ORDERED that judgment be and the same is entered for the plaintiff of one hundred sixty-four thousand one hundred forty-one dol-

lars and three cents ($164,141.03), plus statutory interest.

BY THE COURT

/s/ Daniel M. Friedman
DANIEL M. FRIEDMAN
Chief Judge

IN THE UNITED STATES COURT OF CLAIMS

No. 400-77

[Filed Dec. 7, 1979]

BULL RUN MINING CO., INC.

v.

THE UNITED STATES

ORDER

On July 18, 1979, the court rendered an opinion holding that the plaintiff was entitled to recover and entering judgment to that effect. The determination of the amount of recovery was reserved pending further proceedings pursuant to Rule 131(c).

On November 28, 1979, the trial judge of this court filed a memorandum report recommending that, in accordance with the opinion of the court and the stipulation of the parties, judgment be entered for the plaintiff for $20,960.43, plus statutory interest, which recommendation is adopted by the court.

IT IS THEREFORE ORDERED that judgment be and the same is entered for the plaintiff for

twenty thousand nine hundred sixty dollars and forty-three cents ($20,960.43), plus statutory interest.

BY THE COURT

/s/ Daniel M. Friedman
DANIEL M. FRIEDMAN
Chief Judge

APPENDIX C

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 611. ALLOWANCE OF DEDUCTION FOR DEPLETION.

(a) *General Rule.*—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary. * * *

* * * * *

SEC. 613. PERCENTAGE DEPLETION.

(a) *General Rule.*—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayers' taxable income from the property (computed without allowance for depletion). * * * In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

* * * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.611-1. *Allowance of deduction for depletion.*

(a) *Depletion of mines, oil and gas wells, other natural deposits, and timber*—(1) *In general.* Section 611 provides that there shall be allowed as a deduction in computing taxable income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion. * * * In the case of other exhaustible natural resources the allowance for depletion shall be computed upon either the adjusted depletion basis of the property (see section 612, relating to cost depletion) or upon a percentage of gross income from the property (see section 613, relating to percentage depletion), whichever results in the greater allowance for depletion for any taxable year. In no case will depletion based upon discovery value be allowed.

* * * * *

(b) *Economic interest.* (1) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the extraction of the mineral or severance of the timber, to which he must look for a return of his capital. For an exception in the case of certain mineral production payments, see section 636 and the regulations thereunder. A person who has

no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because through a contractual relation he possesses a mere economic or pecuniary advantage derived from production. For example, an agreement between the owner of an economic interest and another entitling the latter to purchase or process the product upon production or entitling the latter to compensation for extraction or cutting does not convey a depletable economic interest. Further, depletion deductions with respect to an economic interest of a corporation are allowed to the corporation and not to its shareholders.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1980 315022 248

No. 79-1515

In the Supreme Court of the United States

OCTOBER TERM, 1979

UNITED STATES OF AMERICA, PETITIONER

v.

ELWOOD SWANK AND RITA SWANK

UNITED STATES OF AMERICA, PETITIONER

v.

BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA, PETITIONER

v.

BULL RUN MINING CO., INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

SUPPLEMENTAL MEMORANDUM FOR THE UNITED STATES

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1515

UNITED STATES OF AMERICA, PETITIONER

v.

ELWOOD SWANK AND RITA SWANK

UNITED STATES OF AMERICA, PETITIONER

v.

BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA, PETITIONER

v.

BULL RUN MINING CO., INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

SUPPLEMENTAL MEMORANDUM FOR THE UNITED STATES

On page 9 of the petition, we stated that we were advised by the Internal Revenue Service that "there are currently 15 cases pending administratively either on audit or at the appellate level, or in the district courts, with approximately $2,176,383 of revenue at stake."

Upon further investigation of these administrative statistics, we are now advised by the Internal Revenue Service that there are currently 12 cases pending administratively either on audit or at the appellate level, or in the Court of Claims or the Tax Court, with approximately $1,048,888 of revenue at stake.

The names of the six docketed cases involving the question presented and the amounts at issue are as follows:

Wylie Bros. v. *United States* (Ct. Cl. - No. 109-78)	$ 57,032.00
L. W. Hardy Co. v. *United States* (Ct. Cl. - No. 412-77)	720,000.00
Thomas H. Powell v. *Commissioner* (T.C. - No. 1110-80)	36,000.00
Rodney D. Feddle v. *Commissioner* (T.C. - No. 17128-79S)	826.00
Gale Coal Co. v. *Commissioner* (T.C. - No. 12191-79)	51,210.00
Vel Marv Petroleum v. *Commissioner* (T.C. - No. 11493-78)	24,000.00
	$889,068.00

There are also six cases pending administratively within the Internal Revenue Service involving a total of $159,920.00. In one of these cases, the taxpayer has

recently paid the amount of the deficiency but the statute of limitations within which a claim for refund may be filed has not yet expired.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

APRIL 1980

DOJ-1980-04

Supreme Court, U. S.
FILED
JUN 26 1980
MICHAEL RODAK, JR., CLERK

APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1515

UNITED STATES OF AMERICA, PETITIONER

v.

ELWOOD SWANK AND RITA SWANK

UNITED STATES OF AMERICA, PETITIONER

v.

BLACK HAWK CORPORATION, INC.

UNITED STATES OF AMERICA, PETITIONER

v.

BULL RUN MINING CO., INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITION FOR CERTIORARI FILED MARCH 27, 1980
CERTIORARI GRANTED MAY 12, 1980

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1515

UNITED STATES OF AMERICA, PETITIONER

v.

ELWOOD SWANK AND RITA SWANK

UNITED STATES OF AMERICA, PETITIONER

v.

BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA, PETITIONER

v.

BULL RUN MINING CO., INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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RELEVANT DOCKET ENTRIES

GENERAL

No. 403-75

ELWOOD SWANK AND RITA SWANK

v.

THE UNITED STATES

Income tax
November 18 1975

5 COPIES OF PETITION TO DEFENDANT.
$34,926.59
R.D. #1, Box 85 D
Paxinos, PA

Nov 18 1975	Filing fee of $10 paid by plaintiffs.
Dec 10 1975	Notice of reference to Trial Judge C. Murray Bernhardt filed. Copy to parties.
Jan 19 1976	Defendant's answer to the petition filed. Copies (5) to atty.
Nov 26 1976	Defendant's motion for an order directing a response to request for admissions filed. Copies (2) to atty.
Dec 27 1976	Plaintiffs' motion for order directing a response to plaintiffs' request for admissions filed. Copies (2) to deft. DENIED JAN 24 1978 without prejudice.
Dec 27 1976	Plaintiffs' objections to defendant's motion for an order directing a response to request for admissions and request for admissions filed. Copies (2) to deft.
Jan 6 1977	Defendant's reply to plaintiffs' objections to defendant's request for admissions filed. Copies (2) to atty.

Jan 26 1977	Defendant's motion for extension of time (to February 25, 1977) to file objections to request for admissions filed. Copies (2) to atty. ALLOWED FEB 2 1977.
Feb 25 1977	Defendant's motion for extension of time (to March 12, 1977) to respond to request for admissions filed. Copies (2) to atty. ALLOWED MAR 15 1977.
Mar 14 1977	Defendant's supplemental motion for an order directing plaintiffs to respond to defendant's request for admissions, etc. filed. Copies (2) to atty. DENIED NOV 15 1977.
Mar 14 1977	Defendant's objections to plaintiffs' request for admissions filed. Copies (2) to atty.
Mar 28 1977	Plaintiffs' reply to objections to request for admissions filed. Copies (2) to deft.
Apr 11 1977	Plaintiffs' motion to strike defendant's supplemental motion for an order directing plaintiffs to respond to defendant's request for admissions, etc. filed. Copies (2) to deft. SEE ACTION ON MOTION OF MARCH 14, 1977.
Apr 14 1977	Defendant's responses to request for admissions filed. Copies (2) to atty.
Apr 14 1977	Defendant's motion for summary judgment together with appendix in support thereof filed. Copies (5 of motion and 1 of appendix) to atty.
Apr 14 1977	Defendant's motion for leave to file a reduced number of copies (of appendix B) filed. Copies (2) to atty. ALLOWED MAY 6 1977, see endorsement on motion*
May 17 1977	Plaintiffs' brief in opposition to defendant's motion for summary judgment filed. Copies (7) to deft.
May 31 1977	Defendants motion for extension of time (to July 15, 1977) to file its reply brief filed. Copies (2) to atty. ALLOWED JUN 17 1977.

Jul 15 1977	Defendant's motion for extension of time (to August 29, 1977) to file its reply brief filed. Copies (2) to atty. ALLOWED AUG 2 1977 with no further extension of time to be granted except for extraordinary circumstances.
Jul 20 1977	Plaintiffs objections to motion for enlargement of time filed. Copies (2) to deft.
Aug 29 1977	Defendant's motion for extension of time (to September 2, 1977) to file its reply brief filed. Copies (2) to atty. ALLOWED SEP 2 1977.
Sep 2 1977	Defendant's reply brief in support of its motion for summary judgment filed. Copies (5) to atty.
Sep 6 1977	Submitted to the court on defendant's motion for summary judgment.
Nov 11 1977	Court entered order denying defendant's motion for summary judgment and returning the case to the Trial Division as set forth in the order. Copy to parties.
Dec 7 1977	Defendant's motion for leave to take depositions and to serve subpeonas duces tecum filed. Copies (2) to atty. DENIED JAN 5 1978 SEE TRIAL JUDGE'S ORDER THIS DATE.
Dec 21 1977	Plaintiffs' objections and response to motion for leave to take depositions, etc. filed. Copies (2) to deft.
Jan 3 1978	Defendant's reply to plaintiffs' objections to defendant's motion for leave to take depositions and to serve subpoena duces tecum filed. Copies (2) to atty.
Jan 3 1978	Defendant's motion for leave to take depositions and to serve subpoenas duces tecum filed. Copies (2) to atty. SEE TRIAL JUDGE'S ORDER JAN 24 1978 denying, without prejudice.

Jan 5 1978	Trial judge's order on defendant's motion Re: depositions, etc., filed. Copy to parties.
Jan 9 1978	Plaintiffs' motion for leave to amend petition filed. Copies (2) to deft. ALLOWED JAN 23 1978.
Jan 13 1978	Plaintiffs' objections and response to defendant's motion for leave to take depositions and to serve subpoenas duces tecum filed. Copies (2) to deft.
Jan 19 1978	Partial stipulation of facts filed by defendant. Copy to atty,
Jan 24 1978	Trial judge's order on defendant's motion re: depositions* filed. Copy to parties. (*DENIED, without prejudice).
Feb 22 1978	Trial judge's memorandum re pretrial conference filed. Copy to parties.
Mar 15 1978	Plaintiffs' amendment to petition filed. Copies (5) to deft.
Apr 14 1978	Defendant's amended answer filed. Copies (5) to atty.
Apr 20 1978	Transcript of testimony (one volume), taken at Harrisburg, Pennsylvania on March 14, 1978, together with plaintiff's exhibits 1 through 3, and defendant's exhibits 1 through 5 filed. Notice to parties.
Apr 24 1978	Trial judge's order closing proof, etc. filed. Copy to parties.
May 22 1978	Plaintiffs' motion for extension of time (to June 13, 1978) to file requested findings of fact and brief filed. Copies (2) to deft. ALLOWED MAY 22 1978.
Jun 7 1978	Supplemental stipulation of facts filed by defendant. Copies (2) to atty.
Jun 12 1978	Plaintiff's motion for extension of time (to June 23, 1978) to file requested findings of fact and brief filed. Copies (2) to deft. ALLOWED JUN 13 1978.

Jun 16 1978	Plaintiffs' requested findings of fact and brief filed. Copies (2) to deft.
Jul 17 1978	Defendant's motion for extension of time (to August 31, 1978) to file its requested findings, etc. filed. Copies (2) to atty. ALLOWED JUL 18 1978.
Aug 31 1978	Defendant's objections to plaintiffs' requested findings of fact filed. Copies (2) to atty.
Aug 31 1978	Defendant's requested findings of fact filed. Copies (2) to atty.
Aug 31 1978	Defendant's brief to the Trial Judge filed. Copies (2) to atty.
Sep 13 1978	Plaintiffs' motion for extension of time (to Oct. 10, 1978) to file objections to defendant's requested findings of fact, etc. filed. Copies (2) to deft. ALLOWED SEP 13 1978.
Sep 14 1978	Plaintiffs' amendment to requested finding of fact No. 31 filed. Copies (2) to deft. (BLOTJ).
Oct 3 1978	Defendant's motion for leave to file objection to plaintiffs' supplemental requested findings of facts filed. Copies (2) to atty. ALLOWED OCT 3 1978 & filed.
Oct 3 1978	Defendant's objection to supplemental information sought to be added to plaintiff's requested finding 31 filed. Copies (2) to atty.
Oct 10 1978	Plaintiffs' objections to defendant's findings of fact and reply brief filed. Copies (2) to deft.
Nov 6 1978	Trial judge's opinion and findings of fact filed. Copies (5) to parties.
Dec 11 1978	Defendant's motion for leave to file out of time notice of intent to except to trial judge's findings of fact and conclusions of law filed. Copies (2) to atty. ALLOWED DEC 11 1978.

Dec 11 1978	Defendant's notice of intent to except to trial judge's findings of fact, opinion, etc. filed. Copies (2) to atty.
Dec 21 1978	Defendant's motion for enlargement of time (to January 20 1979) to file its brief and exceptions to the Trial Judge's findings of fact filed. Copies (2) to atty. ALLOWED JAN 8 1978.
Jan 22 1979	Defendant's exceptions and brief filed. Copies (5) to atty.
Feb 15 1979	Plaintiffs' motion for enlargement of time (to March 8 1979) to file its opposing brief filed. Copies (2) to deft. ALLOWED FEB 16 1979.
Mar 5 1979	Plaintiffs' opposing brief filed. Copies (5) to deft.
Mar 28 1979	Defendant's motion for leave to file out of time a motion for enlargement of time to file reply brief filed. Copies (2) to atty. ALLOWED MAR 30 1979.
Mar 30 1979	Defendant's motion for extension of time (to April 14, 1979) to fill its reply brief filed. Copies (2) to atty. ALLOWED MAR 30 1979.
Apr 13 1979	Defendant's reply brief filed. Copies (5) to atty.
May 15 1979	See 400-77 for defendant's motion for order directing consolidation.
Jun 4 1979	See 400-77 for argument and submission.
Jul 18 1979	The court concludes that plaintiffs in each case [in this, 49-77, and 400-77], are entitled to recover taxes and interest assessed, plus interest as provided by law with the amounts of recovery to determined pursuant to Rule 131(c). Opinion Per Curiam.
Nov 21 1979	Stipulation for entry of judgment filed by defendant. Copies (2) atty.

Nov 26 1979	Trial Judge's memorandum report for judgment filed. Copy to parties.
Nov 30 1979	Court filed order entering judgment for plaintiffs' in the sum of $35,806.07, plus statutory interest. Copy to parties.
Nov 30 1979	Certified transcript of judgment mailed to attorney of record.

IN THE UNITED STATES COURT OF CLAIMS

ELWOOD SWANK AND RITA SWANK

Plaintiffs

v.

Docket No.

UNITED STATES OF AMERICA

Defendant

PETITION

1. This is an action for the recovery of Internal Revenue taxes and interest thereon which were erroneously, illegally and improperly assessed and collected from plaintiffs by defendant. Jurisdiction is based upon the provisions of 28 U.S.C. Sections 1346(a)(1) and 1491.

2. Plaintiffs' names are ELWOOD SWANK and RITA SWANK, husband and wife, residing at R.D. #1, Box 85 D, Paxinos, Pennsylvania. The returns for the periods here involved were filed timely with the District Director of Internal Revenue, Philadelphia, Pennsylvania.

3. Defendant is United States of America which, at all times material to this case, was acting by or through its District Director, Internal Revenue Service, Mid-Atlantic Region, in Philadelphia, Pennsylvania.

4. Plaintiffs timely filed their joint 1966 and 1967 United States Individual Income Tax Returns with the District Director, Internal Revenue Service, Mid-Atlantic Region, in Philadelphia, Pennsylvania, and paid the tax shown to be due thereon in the amount of $9,957.28.

5. In their joint 1966 United States Individual Income Tax Return, Plaintiffs claimed a deduction from ordinary income in the amount of $41,371.24 as a deduction for depletion of coal resources in which Plaintiff Elwood Swank had an economic interest in 1966.

6. In their joint 1967 United States Individual Income Tax Return, Plaintiffs claimed a deduction from ordinary income in the amount of $16,274.00 as a deduction for de-

pletion of coal resources in which plaintiff Elwood Swank had an economic interest in 1967.

7. A deficiency for the year 1966 in the amount of $21,720.11 was assessed by Defendant against Plaintiffs and was paid by Plaintiffs during 1972, together with interest in the amount of $6,055.15 and a penalty in the amount of $763.22 for a total payment of $28,538.48.

8. A deficiency for the year 1967 in the amount of $8,867.74 was assessed by Defendant against Plaintiffs and was paid by Plaintiffs during 1972, together with interest in the amount of $2,899.78, for a total payment of $11,767.52.

9. $19,662.80 of the assessment referred to in paragraph 7 of this Petition and $7,351.79 of the assessment referred to in paragraph 8 of this Petition were based respectively upon Defendant's erroneous disallowance of the $41,371.24 referred to in paragraph 5 of this Petition and the $15,204.32 referred to in paragraph 6 of this Petition as deductions for depletion claimed from gross income reported on Schedule C of their joint 1966 and 1967 United States Individual Tax Returns respectively.

10. Pursuant to a Deep Mining Lease, dated October 24, 1964, by and between the County of Northumberland, Lessor, and Plaintiff Elwood Swank, a sole proprietor, t/d/b/a Split Vein Coal Company, Plaintiff Elwood Swank, as an independent coal mining operator, engaged in the extraction of coal by the process of deep mining, during 1966 and 1967 on 112 acres of land at or near Trevorton, Northumberland County, Pennsylvania. A copy of this lease is attached hereto as Exhibit "A" and made a part hereof.

11. Pursuant to a Deep Mining Lease, dated October 26, 1966, by and between the County of Northumberland, as Lessor, and Plaintiff Elwood Swank, a sole proprietor, t/d/b/a Split Vein Coal Company, Plaintiff Elwood Swank as an independent coal mining operator, engaged in the extraction of coal by the process of deep mining, during 1966 and 1967, on 1,371.5 acres of land in the Township of Coal, Northumberland County, Pennsylvania. A copy of

this lease is attached hereto as Exhibit "B" and made a part hereof.

12. Pursuant to a Stripping Lease, dated July 25, 1966, by and between the County of Northumberland, as Lessor, and Plaintiff Elwood Swank, a sole proprietor, t/d/b/a Split Vein Coal Company Plaintiff Elwood Swank, as an independent coal mining operator, engaged in the extraction of coal by the process of strip mining, during 1966 and 1967, on 133 acres of land in the Township of Coal, Northumberland County, Pennsylvania. A copy of this lease is attached hereto as Exhibit "C" and made a part hereof.

13. Under the laws of the Commonwealth of Pennsylvania, the three leases referred to in paragraphs 10, 11 and 12 of this Petition (hereinafter the "leases") vested in Plaintiff Elwood Swank a fee simple interest in the coal in place by sale and purchase, subject only to the condition that the coal be removed within the period specified in the lease. The transaction left no interest in the Lessor other than the royalties with such attendant rights as were necessary to protect such royalty interest.

14. As an independent miner, Plaintiff Elwood Swank was under no obligation to sell the coal to the Lessor or to any other party. He could sell the coal to whom he pleased and at whatever price he could obtain. The mining operations of Plaintiff Elwood Swank were not supervised or controlled in any manner, except that the Lessor could inspect the premises to determine that the maximum amount of coal was being withdrawn by Plaintiff Elwood Swank without damage to the surrounding interest. Under the leases, Plaintiff Elwood Swank had the right to mine the coal to exhaustion.

15. The coal mined from the operations under the leases was delivered by Plaintiff Elwood Swank to his breaker for cleaning and sizing, and, thereafter, was sold by Plaintiff Elwood Swank on the open market to the general public.

16. The Lessor under the leases derives no income from the mining operations under the leases, except the royalty

of 35 cents per gross ton of raw coal removed from the land.

17. The Lessor under the leases retained no right to terminate the leases except for noncompliance with the convenants in the leases relating to royalties and the conditions of operation or upon failure to continue work on the leased premises for a period of 30 days. The latter provisions are normal provisions in all mineral leases in the anthracite region and are inserted only for the protection of the royalty interest of the Lessor.

18. The interest of Plaintiff Elwood Swank under the leases constitutes an economic interest in the coal in place, as that term is used in U.S. Treasury Regulations Section 1.611-1(b).

19. On or about February 25, 1974, Plaintiffs filed timely Claims for Refund for the years 1966 and 1967 with the District Director, Internal Revenue Service, Mid-Atlantic Region, in Philadelphia, Pennsylvania. Copies of these Claims for Refund are attached hereto as Exhibit "D."

20. Plaintiffs received a notice from Defendant dated January 14, 1975, which stated that Defendant proposed to disallow Plaintiffs' Claims for Refund.

21. During March, 1975, Plaintiffs received notices from Defendant, dated March 13, 1975, which advised Plaintiffs that Defendant formally had disallowed Plaintiffs' Claims for Refund.

22. The actions of Defendant in assessing and collecting the deficiencies referred to in paragraphs 7 and 8 of this Petition and in disallowing Plaintiffs' Claims for Refund were improper, illegal and erroneous.

23. Plaintiffs have overpaid their United States Individual Income Tax for the years 1966 and 1967 in the amount of $27,014.59 with interest in the amount of $7,912.00, which amounts together with interest as provided by law are due and owing to Plaintiffs from the Defendant.

WHEREFORE, Plaintiffs pray that judgment be entered

in their favor in the amount of $34,926.59, together with interest as provided by law, and that the Court grant such other relief as it may deem proper and that Plaintiffs be awarded their costs.

Respectfully submitted,

LLOYD R. PERSUN
HOWELL C. METTE
SHEARER, METTE & WOODSIDE
P.O Box 729
Harrisburg, Pennsylvania 17108
717-232-6701
Attorneys for Plaintiffs

[Exhibits omitted.]

IN THE UNITED STATES COURT OF CLAIMS

No. 403-75

ELWOOD AND RITA SWANK,

Plaintiffs

v.

THE UNITED STATES,

Defendant

ANSWER

JAN 19 1976

Defendant, for its answer to the petition filed in the above-entitled case, denies each and every allegation contained therein, except as specifically admitted herein. Defendant further:

1. Admits jurisdiction pursuant to 28 U.S.C. Section 1491, but denies the remainder of the allegations contained in paragraph 1.

2-4. Admits the allegations contained in paragraphs 2 through 4.

5-6. Denies the allegations contained in paragraphs 5 and 6.

7. Admits that in 1972 plaintiffs were assessed and paid $21,720.11 in additional tax and $6,055.15 in interest for 1966, but denies the remainder of the allegations contained in paragraph 7.

8. Admits that in 1972 plaintiffs were assessed and paid $8,867.74 in additional tax for 1967, but denies the remainder of the allegations contained in paragraph 8.

9. Denies the allegations contained in paragraph 9.

10-12. Admits the allegations contained in paragraphs 10 through 12.

13. Denies the allegations contained in paragraph 13.

14–16. Avers that its attorney is presently unable to obtain knowledge or information sufficient for him to form a belief as to the truth of the allegations contained in paragraphs 14 through 16.

17–18. Denies the allegations contained in paragraphs 17 and 18.

19. Admits the allegations contained in paragraph 19, except denies each and every allegation in the claims for refund not specifically admitted herein.

20–21. Admits the allegations contained in paragraphs 20 and 21.

22–23. Denies the allegations contained in paragraphs 22 and 23.

WHEREFORE, defendant prays that plaintiffs' petition be dismissed with costs assessed against the plaintiffs.

Respectfully submitted.

MYRON C. BAUM *Acting Assistant Attorney General*
CHARLES E. AUSLANDER, JR.
January 16, 1976

IN THE UNITED STATES COURT OF CLAIMS

Docket No. 403-75

ELWOOD SWANK AND RITA SWANK,

Plaintiffs

v.

UNITED STATES OF AMERICA

Defendant

AMENDMENT TO PETITION

AND NOW, this 13th day of March, 1978, in accordance with leave granted by the Learned Trial Judge on January 23, 1978, Plaintiffs hereby amend the Wherefore clause of their Petition as follows:

WHEREFORE, Plaintiffs pray that judgment be entered in their favor in the amount of $34,926.59, together with interest as provided by law and reasonable attorneys' fees and costs of counsel in preparation and presentation of their case, and that the Court grant such other relief as it may deem proper and that Plaintiffs be awarded their costs.

Respectfully submitted,

LLOYD R. PERSUN
HOWELL C. METTE
SHEARER, METTE & WOODSIDE
P.O. Box 729
1801 North Front Street
Harrisburg, Pennsylvania 17108
717-232-6701
Attorneys for Plaintiffs

IN THE UNITED STATES COURT OF CLAIMS

No. 403-75

ELWOOD SWANK AND RITA SWANK,
Plaintiffs

v.

THE UNITED STATES,
Defendant

AMENDED ANSWER

Defendant repeats the responses set forth in its answer to plaintiffs' petition filed November 18, 1975, and states further:

Plaintiffs, having filed an amendment to petition on March 15, 1978, in which they pray for relief including "reasonable attorneys' fees and costs of counsel in preparation and presentation of their case," defendant here states that this Court is without jurisdiction to grant such relief.

WHEREFORE, having responded to the matters raised in plaintiffs' amendment to petition, defendant respectfully requests that plaintiffs' petition, as amended, be dismissed with costs assessed against plaintiffs.

Respectfully submitted,

M. CARR FERGUSON
Assistant Attorney General

JAMES L. MALONE III
Attorney

April 14, 1978

IN THE UNITED STATES COURT OF CLAIMS

No. 403-75

ELWOOD SWANK AND RITA SWANK,
HIS WIFE, PLAINTIFFS

v.

THE UNITED STATES,
DEFENDANT

PARTIAL STIPULATION OF FACTS

AND NOW, this 14th day of December, 1977, it is hereby stipulated and agreed by and between the parties hereto by their respective counsel, for the purposes of this case only, that the following facts may be accepted as true and that the copies of the documents hereto annexed and identified as exhibits are genuine and are true and exact copies of the original thereof, each party, however, reserving the right to object to the relevance and materiality of said facts and documents:

1. Plaintiffs are Elwood and Rita Swank, husband and wife, residing at R.D. #1, Box 85 D, Paxinos, Pennsylvania (hereinafter collectively referred to as "Taxpayers"). Reference hereinafter to "Taxpayer" means husband only, the wife being joined only because of the filing of joint tax returns by Taxpayers during 1966 and 1967.

2. Defendant is the United States of America (hereinafter the "Government").

3. Taxpayer owned and operated a sole proprietorship trading and doing business as Split Vein Coal Company during the entire calendar year 1966 and during the period from January 1, 1967 through April 30, 1967. On May 1, 1967, Taxpayer transferred the assets of his sole proprietorship, Split Vein Coal Company, to Split Vein Coal Company, Inc., in a tax-free incorporation, pursuant to Section 351 of the Internal Revenue Code of 1954, as amended.

4. Taxpayers timely filed their joint 1966 and 1967 United States Individual Income Tax Returns with the District Director, Internal Revenue Service, Mid-Atlantic Region, in Philadelphia, Pennsylvania, and paid the tax shown to be due thereon.

5. In their joint 1966 and 1967 Unaited States Individual Incoem Tax Return, Taxpayers claimed as a deduction from ordinary income a deduction for depletion of coal resources in which Taxpayer claimed an economic interest in 1966 and in 1967.

6. After audit, the Government disallowed the deductions referred to in paragraph 5, above, and, as a result thereof, assessed deficiencies against Taxpayers for the years 1966 and 1967 in the aggregate amount of $30,587.84 which Taxpayers paid under protest to the Government together with assessed interest in the aggregate amount of $3,663.00.

7. At all times material hereto, Split Vein was a sole proprietorship engaged in mining and strip mining anthracite coal as lessee of various mining tracts in the Northumberland County Pennsylvania area. Taxpayer mined only from coal lands which it leased, as Lessee. Taxpayer's mining operations included the deep mining and strip mining methods of mining coal. Taxpayer purchased and owned the machinery and equipment used in its mining operations, and took depreciation deductions on such machinery and equipment.

8. Taxpayer strip mined by using his power shovel to remove the overburdening soil and terrain covering the underlying coal (hereinafter the "overburden"). The power shovel then "stripped" the exposed coal from the earth's surface and placed it in large piles next to loaders. The piled coal then was conveyed by the loaders into trucks which hauled the coal from the leased lands to a breaker where the coal was cleaned and sorted. From the breaker, the coal was sold to the general public on the open market.

9. Taxpayer deep mined by sinking shafts, or inclined slopes, through the overburden into coal veins. When the coal veins were exposed, Taxpayer transported his min-

ers, his employees, in his "buggies", or cars, on rails into the shafts to the coal veins. The miners manually extracted coal from the veins with explosives and pick and shovel and then deposited the extracted coal in the buggies which then transported the extracted coal through the shafts to the earth's surface. At the earth's surface, the coal was trucked to a breaker where, as in the case of strip mined coal, the deep mined coal was cleaned and sorted. From the breaker, the deep mined coal was sold to the general public on the open market.

10. Taxpayer was under no obligation to sell the coal to the Lessor or to any other party. He could sell the coal to whom he pleased at whatever price he could obtain.

11. When the coal was removed from the earth, either by strip mining or deep mining, it was ungraded as to size and contained slate and rock, thereby requiring sorting and cleaning. This cleaning and sorting process was accomplished by using a breaker (which sometimes is called a tipple). A breaker is a plant for processing coal. The breaker removed the slate and rock, and sorted the coal into seven sizes for sale to the general public on the open market. The price per ton of coal varied based on the quality of the coal and the market conditions at the time when the coal was sold to the public.

12. The County of Northumberland is a political subdivision of the Commonwealth of Pennsylvania, and is a county of the fifth class.

13. From time to time, Northumberland County has acquired legal title to substantial acreage of land containing substantial deposits of anthracite by purchase at County Treasurer's sales for delinquent taxes levied by the County and by various Townships and school districts in Northumberland County wherein the land is located. Fee simple title was acquired by the County by virtue of the right of County Commissioners to purchase said land under Section 10 of the Act of May 29, 1931, P.L. 280, as amended, 72 P.S. §5971(j). Said land is held by the County as trustee for the County and the school districts and Townships in which the land is located. During the years

in issue, Northumberland County owned over 17,500 acres of land in Zerbe Township, Coal Township, Mount Carmel Township, East Cameron Township and West Cameron Township, all having been acquired by purchase at County Treasurer's sales for unpaid taxes.

14. The Northumberland County Commissioners, in whom the authority for the operation of county government is vested, entered into leases with individuals, partnerships and corporations for the extraction and removal of coal from the county-owned land in consideration for the payment of royalties to the county. During the taxable years involved, Northumberland County Commissioners collected from Taxpayer the following royalties from coal lands owned by Northumberland County and leased to Taxpayer:

1966 — $7,545.10
1967 — 6,854.05

15. Pursuant to a deep mining lease dated October 24, 1964, by and between the County of Northumberland, as Lessor, and Taxpayer, as miner, Taxpayer engaged in the extraction of coal by the process of deep mining, during 1966 and 1967, on 112 acres of land out or near Trevorton, Northumberland County, Pennsylvania. A copy of this lease is attached hereto as Exhibit "A" and made a part hereof. This lease was terminated in May, 1968 because a mountain slide caused by heavy rains closed the deep mine, thereby preventing further mining of the mine by anyone. In May 1968, rain fell in the Northumberland County, Pennsylvania area on 29 of the 31 days in that month.

16. Pursuant to a deep mining lease dated October 26, 1966, by and between the County of Northumberland, as Lessor, and Taxpayer, as Miner, Taxpayer engaged in the extraction of coal by the process of deep mining, during 1966 and 1967, on 1,371.5 acres of land in the Township of Coal, Northumberland County, Pennsylvania. A copy of this lease is attached hereto as Exhibit "B" and made a part hereof. This lease is still in effect, and Taxpayer's

corporation, Split Vein Coal Company, Inc., is still mining the leasehold pursuant thereto.

17. Pursuant to a stripping lease dated July 25, 1966, by and between the County of Northumberland, as Lessor, and Taxpayer, as Miner, Taxpayer engaged in the extraction of coal by its process of strip mining, during 1966 and 1967 on 133 acres of land in the Township of Coal, Northumberland County, pennsylvania. A copy of this lease is attached hereto as Exhibit "C" and made a part hereof. This lease is still in effect, and Taxpayer's corporation, Split Vein Coal Company, Inc., is still mining the leasehold pursuant thereto.

18. Taxpayer purchased the equipment itemized on Exhibit "D" attached hereto and made a part hereof for use in the mining operations described in this Partial Stipulation of Facts. The said equipment was so used at all times material hereto.

19. The Lessor under the leases described in paragraphs 16, 17 and 18, above (hereinafter the "leases") derived no income from the mining operations under the leases, except the royalty of 35 cents per gross ton of raw coal removed by Taxpayer from the land.

20. The number of employees of Taxpayer during the tax years involved was as follows:

1966 — 14
1967 — 14

21. On or about February 25, 1974, Taxpayers filed timely claims for refund for the years 1966 and 1967 with the District Director, Internal Revenue Service, Mid-Atlantic Region, in Philadelphia, Pennsylvania. The claims for refund were disallowed. Taxpayers timely filed this appeal.

22. The only legal issue before the Court is whether Taxpayer had such an economic interest in the anthracite coal in place under the leases to support a deduction from gross income for depletion under Section 613 of the Internal Revenue Code of 1954, as amended, for the years 1966 and 1967. If the Court so decides, Taxpayers are entitled

to a refund of Federal Income Tax with interest thereon as provided by law, which refund shall later be computed.

Respectfully Submitted,

JAMES L. MALONE, III, ESQUIRE
Department of Justice
Tax Division
Washington, D.C. 20530

LLOYD R. PERSUN
HOWELL C. METTE
SHEARER, METTE & WOODSIDE
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Harrisburg, Pennsylvania 17108

M. CARR FERGUSON
Assistant Attorney General

EXHIBIT A

DEEP MINING LEASE

THIS AGREEMENT, made and concluded the 24th day of October, A.D., 1964 by and between the COUNTY OF NORTHUMBERLAND, acting by and through W. Fred Kohler, Fred E. Hoffman and Oscar Kehler its duly elected and qualified County Commissioners, who are hereby acting and contracting for and on behalf of the said County and also as Trustee for the various municipal subdivisions interested in the hereinafter described property, (hereinafter called LESSOR), Party of the First Part, and Split Vein Coal Company—R.D. #1, Paxinos, Penna. Northumberland County, Pennsylvania, (hereinafter called MINER), Party of the Second Part:

WITNESSETH

IN CONSIDERATION of the covenants and agreements hereinafter contained, and in consideration of the sum of ONE ($1.00) DOLLAR, each to the other in hand paid, the receipt whereof is hereby acknowledged, it is

agreed by and between LESSOR AND MINER, the parties of this agreement, as follows:

1. LESSOR, insofar as it has the power and authority so to do, hereby leases and lets unto MINER the coal underlying the following described tract of land, together with the right and privilege of mining and removing the same, but not including any other mineral, gas or substance and not including the right to cut or remove timber, which premises are described as follows, to wit:

> Being Independent Mining Operation No. W-111
> In the No 1 Vein, North dip,
> at or near Southwest of Trevorton, Pa.
> Located on Jeremiah Jackson Tract 112 acres.
> Situate in the Township of West Cameron
> More particularly described as follows:

More particularly described as follows:

> The western limit of this lease is the western line of the Jeremiah Jackson Tract in West Cameron Township. The eastern line is 750 feet east of the above mentioned western line.
>
> A reservation pillar of 100 feet shall be maintained at the eastern limit of this lease with 50 feet to be held by the present lessee and 50 feet to be held by any adjoining lessee.
>
> The mining limit of this lease is for a distance of 700 feet in the Number 1 vein, north dip of the Jeremiah Jackson Tract in West Cameron Township, southwest of Trevorton, Pa.
>
> The lessee shall have a survey made within six months from the date of this lease and periodically or at any time the county Engineers should find it necessary and furnish the County Engineers with a print showing the location of the surface opening and workings on this lease.

2. The LESSOR hereby grants, demises and lets unto the MINER the right and privilege of digging, mining and carrying away anthracite coal wholly at his own expense and cost in and from the described premises, in accordance with the terms and conditions of this agreement.

3. MINER hereby agrees, from and after the exectuion and delivery of this agreement, and until the MINER shall have finally ceased, whether voluntarily or involuntarily, mining upon any or all of said premises, that MINER shall pay as rent and royalty to LESSOR weekly the sum of THIRTY FIVE ($.35) CENTS per gross ton of two thousand two hundred forty (2,240) pounds of raw coal removed from said land. It is understood that the term "raw coal" as used herein shall mean the material taken from the ground, prior to any preliminary cleaning and prior to the time when it shall be prepared in any manner whatsoever.

The MINER agrees to pay the LESSOR the royalty for the said coal or have the same deducted and paid for him by the purchaser of said coal within one week from the time that the coal is mined and removed.

4. The MINER agrees to have all raw coal mined and removed from said tract delivered to any breaker designated by the LESSOR except that the MINER may, with prior consent in writing of the LESSOR, change breakers from time to time, and the LESSOR agrees not to unreasonably withhold its consent to change, provided, however that no coal shall be taken to a breaker outside of Northumberland County. The MINER further agrees that the part breaker operator to whom the coal is delivered shall deduct the herein specified royalty on the gross weight as herein specified upon the delivery of each load of raw coal removed from the said tract described herein.

5. All royalty or rent collected by the breaker operator on raw coal delivered from the tract herein described, shall be paid to the LESSOR together with a complete and adequate record of the royalty collected.

6. MINER agrees to have all raw coal mined and removed from said tract weighted at scales by a duly licensed weighmaster of the Commonwealth of Pennsylvania. The scales to be used shall be selected by the MINER from the list of scales approved by the LESSOR and the MINER shall not take any coal to scales not approved by LESSOR.

7. MINER agrees to have all raw coal mined and removed from said tract weighed at the following approved scales, to wit:

(Name of Approved Scales)

8. MINER further agrees that in the event the MINER desires to weigh raw coal at scales other than the scales specified herein, the LESSOR shall be notified in writing of the desire of the MINER and the MINER shall not change scales until such change is approved by the LESSOR and then shall not change except to approved scales on the list of scales approved by the LESSOR.

9. The MINER agrees to keep complete and accurate records of all raw coal removed from the premises and agrees that the agents of the LESSOR shall have the right and privilege of inspecting said books and records at any time. This record shall include the daily gross tonnage of raw coal mined or removed from the said tract. The MINER also agrees to preserve and keep for two (2) years after termination of this lease, a duplicate weight slip for each and every ton of raw coal mined and removed from the said premises. The MINER also agrees to keep and maintain such records as shall be furnished by the LESSOR under this agreement.

10. MINER hereby agrees that the methods and manner of keeping records, making statements, reports and the time and place of payment of the royalties upon the coal mined and removed from the herein described lands may be changed at any time by the LESSOR.

11. MINER hereby agrees that it will work the land herein mentioned continuously and in a skillful and workmanlike manner under the direction and subject to the approval of the LESSOR, its agents or engineers, to its fullest capacity, and to leave no merchantable coal abandoned or neglected which in the opinion of said agent or engineers can be taken out without injury to the mines or lands.

12. MINER hereby agrees to comply with all the laws of the United States of America and the Commonwealth of Pennsyvlania and to secure any permits and licenses which may be required by the United States of America or Commonwealth of Pennsylvania and particularly from the Pennslyvania Department of Forests and Waters before engaging in any mining under this lease.

13. MINER hereby agrees to protect and save harmless the LESSOR from all liability of whatsoever kind or nature which may be caused by, or which may flow from, the operations of said MINER upon said land.

14. This agreement shall in no way nullify, invalidate or impair in any way the title of the LESSOR and payment of the royalties or rents hereunder shall in no way work or be construed as a redemption either in whole or in part, or as a sale of said land either in whole or in part; nor shall it be construed as an abandonment by the LESSOR of this land, but said tract of land shall remain in the hands of the County Commissioners as LESSOR and the payments made hereunder shall be payments in the nature of rent or royalty. The LESSOR and its said Commissioners, W. Fred Kohler, Fred E. Hoffman and Oscar Kehler, neither individually nor in any capacity assume any liability hereunder except to receive and turn over the Treasurer of Northumberland County such moneys as are received hereunder, so that the County Treasurer may properly distribute them among the various municipal subdivisions interested in the said lands in such proportions as each may be entitled to under the law. It is further understood between the parties hereto that in the event of a sale of said lands by the County or a redemption in full of the said lands by those persons legally entitled to redeem the same, that this lease shall then immediately terminate as well as all rights of the MINER hereunder.

15. It is expressly understood between the parties hereto that the MINER shall operate the lands herein leased as an independent contractor and not as the agent, servant, or employee of LESSOR, and any provision in this agreement pertaining to supervision, inspection or in-

structions by LESSOR, its representatives, engineers, employees or agents, is not intended to, nor shall it be construed in any way, to create a master and servant relationship between the parties hereto.

16. MINER hereby agrees not to transfer, assign, mortgage, or encumber with liens of any kind whatsoever the estate hereby granted, either in whole or in part, nor interest or associate any other person, corporations or associations in the estate hereby granted without prior written consent of the LESSOR first had and obtained.

17. It is hereby expressly understood between the parties hereto that the MINER is granted the right and privilege (as hereinabove limited) to remove coal from the hereinabove mentioned land by deep mining methods only and that the MINER shall not remove or cause to be removed coal from the hereinabove described land by the open pit or strip mining method. This agreement shall automatically terminate and cease to have any binding effect and force in the event that the MINER for any cause or reason whatsoever, not due to abnormal conditions, shall cease to mine and remove coal from the aforedescribed premises for a period of at least thirty consecutive days, and in the event of his failure to so mine, the LESSOR at its option may, without taking any legal procedure, declare this lease void and retake possession of the demised premises together with any and all improvements situated thereon.

18. The MINER agreed to permit ingress, egress and regress over the leased premises for all persons who have other agreements with the LESSOR for the mining of coal.

19. Any violation of any of the terms of this agreement by the MINER shall immediately cancel the same.

20. It is hereby expressly understood between the parties hereto that LESSOR may terminate this agreement completely and fully and without liability upon it or any further recourse against it, upon thirty days written notice given to MINER or by posting the same upon the lands hereinabove mentioned.

21. Should the presently located operation of the MINER on the above described tract interfere with other operations, LESSOR reserves the right to relocate such presently located operations of the MINER to a new location on the above described trace of land as may be available to and agreed upon by the MINER and in the event of such relocation the MINER will be given the first preference for a new location.

22. In the event of any dispute pertaining to mining matters between MINERS who have agreements from the LESSOR, the said matters shall be submitted to the county engineers whose decisions shall be final. A failure of any MINER to obey the decision of such engineers shall operate as a cancellation of this lease.

23. MINER agrees at all reasonable time to permit the LESSOR or its agents or engineers to go upon and inspect the demised premises and every part thereof.

24. MINER agrees to peacefully deliver up and surrender possession of the demised premises to the LESSOR at the expiration or sooner termination of this agreement or any renewal or extension thereof.

25. The MINER shall furnish to the LESSOR at least twice a year a correct map and survey of all his or its underground workings brought up to date. The first map shall be submitted on or before May 1, 1956, and each six months thereafter during the continuance of this agreement.

26. All rights and liabilities herein given to or imposed upon the respective parties hereto shall extend to and bind the several and respective heirs, executors, administrators, successors and assigns of the parties, except as other wise herein set forth; and if there shall be more than one MINER they shall all be bound jointly and severally by the terms, convenants and agreements herein and the word MINER shall be taken and deemed to mean each and every person or party mentioned herein, be the same one or more, and if there shall be more than one MINER any notice required or permitted by the terms of this agreement may be given by or to any one thereof and it shall

have the same force and effect as if given by or to all thereof. No rights, however, shall enure to the benefit of any assignee of MINER unless the assignment to such MINER has been first approved by LESSOR in writing as aforesaid.

27. All notices required to be given by the LESSOR to the MINER shall be sufficiently given if either mailed to the MINER at his last known address or if the same be posted on the demised premises. It is agreed that the LESSOR has let the demised premises in their present condition and without any representations on the part of the LESSOR, its employees, engineers or agents. It is understood by the MINER that in granting this lease LESSOR makes no representation of any kind as to whether there is any anthracite coal located on the leased premises.

28. This agreement, subject to all of its terms and conditions, shall be in effect until termination of lease subject, however, to the length of time during which the County of Northumberland remains the owner of said premises and subject, also, to the right on the part of the LESSOR to increase the royalties hereunder by a thirty day written notice to the MINER, provided that such increase shall not be more than five cents a gross ton during the term of this agreement. MINER further agrees, upon receipt of such notice increasing the royalty, to be bound by the same with the same force and and effect as through such increased amount were stated in this lease, and the failure to pay such increased royalty shall be considered a default under this agreement, subjecting the MINER to the penalties herein provided.

20. If the rent or royalty herein agreed to be paid shall remain unpaid when the same ought to be paid, MINER hereby empowers any Prothonotary or attorney of any court of record to appear for MINER in any and all actions which may be brought for rent and/or royalty as herein agreed to be paid by MINER, and to sign for MINER an agreement for entering in any competent court an amicable action or actions for the recovery of such rent or roy-

alty, and in said suits or said amicable action, to confess judgment against MINER for all or any part of the rent or royalty specified in this agreement and then unpaid, together with costs and with an attorney's commission of 10%. Such authority shall not be exhausted by one exercise thereof but judgment may be confessed as aforesaid, from time to time, as often as any of said rent or royalty shall fall due or be in arrears and such powers may be exercised as well after the expiration either of the original term and/or during any extension or renewal of this term, and may be exercised successively and as often as payments herein reserved may fall due. It is further agreed by MINER that a copy of this agreement shall be sufficient evidence of the same and may be filed in said amicable action.

30. Upon the breach of any of the covenants, obligations or agreements of this agreement, and when this agreement shall be determined by condition broken, either during the original term of the agreement or any renewal or extension thereof, and also when and as soon as the term hereby created or any extension thereof, shall have expired, the LESSOR may declare this agreement null and void and of no effect, and upon default, expiration or termination in any way herein provided, it shall be lawful for any attorney as attorney for the LESSOR to file an agreement for entering in any competent court an amicable action in ejection against MINER and all persons claiming under the MINER for the recovery by the LESSOR of possession of the herein demised premises for which this agreement or a copy thereof shall be his sufficient warrant. Whereupon, the Prothonolary or any other attorney of any court of record is hereby authorized and empowered by the MINER to appear for him and confess judgment or judgments in an amicable action or actions of ejectment against the said MINER and in favor of the LESSOR for the said premises or any other premises of the LESSOR then occupied by the MINER, and to direct the immediate issuance of a writ or writs of habere facias possessionen with clause of fieri facias for costs, waiving all irregularities, without notice and without asking leave

of court, and if after such action shall have been commenced, the same shall be determined and the possession of the premises hereby demised shall remain in or be restored to the MINER, LESSOR shall have the right upon any subsequent default or defaults or upon subsequent termination of this agreement as hereinbefore set forth, to bring one or more amicable action or actions from time to time as hereinbefore set forth, to recover possession of said premises and the said powers herein granted may be exercised as often as default shall occur and such authority shall not be exhausted by one exercise thereof.

31. All the remedies hereinbefore given to LESSOR and all rights and remedies given to it by law and equity shall be cumulative and concurrent. No determination of this agreement or the taking or recovering of the premises shall deprive LESSOR of any of its remedies or actions against the MINER for rent due at the time, or which under the terms hereof would in the future become due as if there has been no determination, or for sums due at the time or which under the terms hereof would in the future become due, nor shall the bringing of any action for rent or breach of covenant or resort to any other remedy herein provided for the recovery of rent be construed as a waiver of the right to obtain possession of the premises.

IN WITNESS WHEREOF, the parties hereto have hereunto set their respective hands and seals the day and year first above written.

ATTEST: COUNTY OF NORTHUMBERLAND

EXHIBIT B

DEEP MINING LEASE

THIS AGREEMENT, made and concluded the 26th day of October A.D. 1966 by and between the COUNTY OF NORTHUMBERLAND, acting by and through W. Fred Kehler, Fred E. Hoffman and Oscar Kehler its duly elected and qualified County Commissioners, who are hereby acting and contracting for and on behalf of the said County and also as Trustee for the various municipal sub-

divisions interested in the hereinafter described property, (hereinafter called LESSOR), Party of the First Part, and Split Vein Coal Company—R.D. #1, Paxinos, Pennsylvania Northumberland County, Pennsylvania, (hereinafter called MINER), Party of Second part:

WITNESSETH

IN CONSIDERATION of the convenants and agreements hereinafter contained, and in consideration of the sum of ONE ($1.00) DOLLAR each to the other in hand paid, the receipt whereof is hereby acknowledged, it is agreed by and between LESSOR AND MINER, the parties of this agreement, as follows:

1. LESSOR, insofar as it has the power and authority so to do, hereby leases and lets unto MINER the coal underlying the following described tract of land, together with the right and privilege of mining and removing the same, but not including any other mineral, gas or substance and not including the right to cut or remove timber, which premises are described as follows, to wit:

Being Independent Mining Operation No. C-692
In the No 8 & 9 Veins North and South dips
at or near East of Bridy's Bank
Located on Fulton Lands (James Jenkins) Tract 1371.5 acres.
Situate in the Township of Coal
More particularly described as follows:

More particularly described as follows:

The eastern limit of this lease is the boundry line between the Fulton Coal Company Tract and the McIntyre Tract. The western limit of this lease is 1200 feet west of the above boundry line.

The mining limit of this lease is for a distance of 1200 feet in the number 8 and 9 veins, north and south dips on the Fulton Lands (James Jenkins Tract), in Coal Township.

The lessee shall have a survey made within six months from the date of this lease and periodically or at any time the County Engineer should find it necessary and furnish the County Engineer with a print

showing the location of the surface openings and workings on this lease.

2. The LESSOR hereby grants, demises and lets unto the MINER the right and privilege of digging, mining and carrying away anthracite coal wholly at his own expense and cost in and from the described premises, in accordance with the terms and conditions of this agreement.

3. MINER hereby agrees, from and after the execution and delivery of this agreement, and until the MINER shall have finally ceased, whether voluntarily or involuntarily, mining upon any or all of the said premises, that MINER shall pay as rent and royalty to LESSOR weekly the sum of THIRTY FIVE ($.35) CENTS per gross ton of two thousand two hundred forty (2,240) pounds of raw coal removed from said land. It is understood that the term "raw coal" as used herein shall mean the material taken from the ground, prior to any preliminary cleaning and prior to the time when it shall be prepared in any manner whatsoever.

The MINER agrees to pay the LESSOR the royalty for the said coal or have the same deducted and paid for him by the purchaser of said coal within one week from the time that the coal is mined and removed.

4. The MINER agrees to have all raw coal mined and removed from said tract delivered to any breaker designated by the LESSOR except that the MINER may, with prior consent in writing of the LESSOR, change breakers from time to time, and the LESSOR agrees not to unreasonably withhold its consent to change, provided, however that no coal shall be taken to a breaker outside of Northumberland County. The MINER furhter agrees that the part breaker operator to whom the coal is delivered shall deduct the herein specified royalty on the gross weight as herein specified upon the delivery of each load of raw coal removed from the said tract described herein.

5. All royalty or rent collected by the breaker operator on raw coal delivered from the tract herein described, shall be paid to the LESSOR together with a complete and adequate record of the royalty collected.

6. MINER agrees to have all raw coal mined and removed from the said tract weighed at scales by a duly licensed weighmaster of the Commonwealth of Pennsylvania. The scales to be used shall be selected by the MINER from the list of scales approved by the LESSOR and the MINER shall not take any coal to scales not approved by LESSOR.

7. MINER agrees to have all raw coal mined and removed from said tract weighed at the following approved scales, to wit:

(Name of Approved Scales)

3. MINER further agrees that in the event the MINER desires to weigh raw coal at scales other than the scales specified herein, the LESSOR shall be notified in writing of the desire of the MINER and the MINER shall not change scales until such change is approved by the LESSOR and then shall not change except to approved scales on the list of scales approved by the LESSOR.

9. The MINER agrees to keep complete and accurate records of all raw coal removed from the premises and agrees that the agents of the LESSOR shall have the right and privilege of inspecting said books and records at any time. This record shall include the daily gross tonnage of raw coal mined or removed from the said tract. The MINER also agrees to preserve and keep for two (2) years after termination of this lease, a duplicate weight slip for each and every ton of raw coal mined and removed from the said premises. The MINER also agrees to keep and maintain such records as shall be furnished by the LESSOR under this agreement.

10. MINER hereby agrees that the methods and manner of keeping records, making statements, reports and the time and place of payment of the royalties upon the coal mined and removed from the herein described hands may be changed at any time by the LESSOR.

11. MINER hereby agrees that it will work the land herein mentioned continuously and in a skillful and work-

manlike manner under the direction and subject to the approval of the LESSOR, its agents or engineers, to its fullest capacity, and to leave no merchantable coal abandoned or neglected which in the opinion of said agent or engineers can be taken out without injury to the mines or lands.

12. MINER hereby agrees to comply with all the laws of the United States of America and the Commonwealth of Pennsylvania and to secure any permits and licenses which may be required by the United States of America or Commonwealth of Pennsylvania and particularly from the Pennsylvania Department of Forests and Waters, before engaging in any mining under this lease.

13. MINER hereby agrees to protect and save harmless the LESSOR from all liability of whatsoever kind or nature which may be caused by, or which may flow from, the operations of said MINER upon said land.

14. This agreement shall in no way nullify, invalidate or impair in any way the title of the LESSOR, and payment of the royalties or rents hereunder shall in no way work or be construed as a redemption either in whole or in part, or as a sale of said land either in whole or in part; nor shall it be construed as an abandonment by the LESSOR of this land, but said tract of land shall remain in the hands of the County Commissioners as LESSOR and the payments made hereunder shall be payments in the nature of rent or royalty. The LESSOR and its said Commissioners, W. Fred Kohler, Fred E. Hoffman and George F. Perles, neither individually nor in any capacity assume any liability hereunder except to receive and turn over to the Treasurer of Northumberland County such moneys as are received hereunder, so that the County Treasurer may properly distribute them among the various municipal subdivisions interested in the said lands in such proportions as each may be entitled to under the law. It is further understood between the parties hereto that in the event of a sale of said lands by the County or a redemption in full of the said lands by those persons legally entitled to

redeem the same, that this lease shall then immediately terminate as well as all rights of the MINER hereunder.

15. It is expressly understood between the parties hereto that the MINER shall operate the lands herein leased as an independent contractor and not as the agent, servant or employee of LESSOR, and any provision in this agreement pertaining to supervision, inspection or instructions by LESSOR, its representatives, engineers, employees or agents, is not intended to, nor shall it be construed in any way, to create a master and servant relationship between the parties hereto.

16. MINER hereby agrees not to transfer, assign, mortgage, or encumber with liens of any kind whatsoever the estate hereby granted, either in whole or in part, nor interest or associate any other person, corporations or associations in the estate hereby granted without prior written consent of the LESSOR first had and obtained.

17. It is hereby expressly understood between the parties hereto that the MINER is granted the right and privilege (as hereinabove limited) to remove coal from the hereinabove mentioned land by deep mining methods only and that the MINER shall not remove or cause to be removed coal from the hereinabove described land by the open pit or strip mining method. This agreement shall automatically terminate and cease to have any binding effect and force in the event that the MINER for any cause or reason whatsoever, not due to abnormal conditions, shall cease to mine and remove coal from the aforedescribed premises for a period of at least thirty consecutive days, and in the event of his failure to so mine, the LESSOR at its option may, without taking any legal procedure, declare this lease void and retake possession of the demised premises together with any and all improvements situated thereon.

18. The MINER agrees to permit ingress, egress and regress over the leased premises for all persons who have other agreements with the LESSOR for the mining of coal.

19. Any violation of any of the terms of this agreement by the MINER shall immediately cancel the same.

20. It is hereby expressly understood between the parties hereto that LESSOR may terminate this agreement completely and fully and without liability upon it or any further recourse against it, upon thirty days written notice given to MINER or by posting the same upon the lands hereinabove mentioned.

21. Should the presently located operation of the MINER on the above described tract interfere with other operations, LESSOR reserves the right to relocate such presently located operations of the MINER to a new location on the above described tract of land as may be available to and agreed upon by the MINER and in the event of such relocation the MINER will be given the first preference for a new location.

22. In the event of any dispute pertaining to mining matters between MINERS who have agreements from the LESSOR, the said matters shall be submitted to the county engineers whose decision shall be final. A failure of any MINER to obey the decision of such engineers shall operate as a cancellation of this lease.

23. MINER agrees at all reasonable time to permit the LESSOR or its agents or engineers to go upon and inspect the demised premises and every part thereof.

24. MINER agrees to peacefully deliver up and surrender possession of the demised premises to the LESSOR at the expiration or sooner termination of this agreement or any renewal or extension thereof.

25. The MINER shall furnish to the LESSOR at least twice a year a correct map and survey of all his or its underground workings brought up to date. The first map shall be submitted on or before May 1, 1956, and each six months thereafter during the continuance of this agreement.

26. All rights and liabilities herein given to or imposed upon the respective parties hereto shall extend to and bind the several and respective heirs, executors, adminis-

trators, successors and assigns of the parties, except as other wise herein set forth; and if there shall be more than one MINER they shall all be bound jointly and severally by the terms, convenants and agreements herein and the word MINER shall be taken and deemed to mean each and every person or party mentioned herein, be the same one or more, and if there shall be more than one MINER any notice required or permitted by the terms of this agreement may be given by or to anyone thereof and it shall have the same force and effect as if given by or to all thereof. No rights, however, shall enure to the benefit of any assignee of MINER unless the assignment to such MINER has been first approved by LESSOR in writing as aforesaid.

27. All notices required to be given by the LESSOR to the MINER shall be sufficiently given if either mailed to the MINER at his last known address or if the same be posted on the demised premises. It is agreed that the LESSOR has let the demised premises in their present condition and without any representations on the part of the LESSOR, its employees, engineers or agents. It is understood by the MINER that in granting this lease LESSOR makes no representation of any kind as to whether there is any anthracite coal located on the leased premises.

28. This agreement, subject to all of its terms and conditions, shall be in effect until termination of lease subject, however, to the length of time during which the County of Northumberland remains the owner of said premises and subject, also, to the right on the part of the LESSOR to increase the royalties hereunder by a thirty day written notice to the MINER, provided that such increase shall not be more than five cents a gross ton during the term of this agreement. MINER further agrees, upon receipt of such notice increasing the royalty, to be bound by the same with the same force and and effect as though such increased amount were stated in this lease, and the failure to pay such increased royalty shall be considered a default under this agreement, subjecting the MINER to the penalties herein provided.

29. If the rent or royalty herein agreed to be paid shall remain unpaid when the same ought to be paid, MINER hereby empowers any Prothonotary or attorney of any court of record to appear for MINER in any and all actions which may be brought for rent and/or royalty as herein agreed to be paid by MINER, and to sign for MINER an agreement for entering in any competent court an amicable action or actions for the recovery of such rent or royalty, and in said suits or said amicable action, to confess judgment against MINER for all or any part of the rent or royalty specified in this agreement and then unpaid, together with costs and with an attorney's commission of 10%. Such authority shall not be exhausted by one exercise thereof but judgment may be confessed as aforesaid, from time to time, as often as any of said rent or royalty shall fall due or be in arrears and such powers may be exercised as well after the expiration either of the original term and/or during any extension or renewal of this term, and may be exercised successively and as often as payments herein reserved may fall due. It is further agreed by MINER that a copy of this agreement shall be sufficient evidence of the same and may be filed in said amicable action.

30. Upon the breach of any of the covenants, obligations or agreements of this agreement, and when this agreement shall be determined by condition broker, either during the original term of the agreement or any renewal or extension thereof, and also when and as soon as the term hereby created or any extension thereof, shall have expired, the LESSOR may declare this agreement null and void and of no effect, and upon default, expiration or termination in any way herein provided, it shall be lawful for any attorney as attorney for the LESSOR to file an agreement for entering in any competent court an amicable action in ejectment against MINER and all persons claiming under the MINER for the recovery by the LESSOR of possession of the herein demised premises, for which this agreement or a copy thereof shall be his sufficient warrant. Whereupon, the Prothonotary or any other attorney of any court of record is hereby authorized and

empowered by the MINER to appear for him and confess judgment or judgments in an amicable action or actions of ejectment against the said MINER and in favor of the LESSOR for the said premises or any other premises of the LESSOR then occupied by the MINER, and to direct the immediate issuance of a writ or writs of habere facias possessionen with clause of fieri facias for costs, waiving all irregularities, without notice and without asking leave of court, and if after such action shall have been commenced, the same shall be determined and the possession of the premises hereby demised shall remain in or be restored to the MINER, LESSOR shall have the right upon any subsequent default or defaults or upon subsequent termination of this agreement as hereinbefore set forth, to bring one or more amicable action or actions from time to time as hereinbefore set forth, to recover possession of said premises and the said powers herein granted may be exercised as often as default shall occur and such authority shall not be exhausted by one exercise thereof.

31. All the remedies hereinbefore given to LESSOR and all rights and remedies given to it by law and equity shall be cumulative and concurrent. No determination of this agreement or the taking or recovering of the premises shall deprive LESSOR of any of its remedies or actions against the MINER for rent due at the time, or which under the terms hereof would in the future become due as if there has been no determination, or for sums due at the time or which under the terms hereof would in the future become due, nor shall the bringing of any action for rent or breach of covenant or resort to any other remedy herein provided for the recovery of rent by construed as a waiver of the right to obtain possession of the premises.

IN WITNESS WHEREOF, the parties hereto have hereunto set their respective hands and seals the day and year first above written.

STRIPPING PERMIT
TO
EXPLORE FOR ANTHRACITE COAL

June 27, 1966

PERMISSION IS HEREBY GRANTED TO Split Vein Coal Company, R.D. #1, Paxinos, Penna. to explore for anthracite coal in accordance with existing mining laws on the Gray & Cleaver Tract (133 acre) in Coal Township, Northumberland County, Pennsylvania, for a period of 90 days from the date of this permit. This permission is granted at the sole cost, expense and liability of the person to whom the permit is granted and the County Commissioners assume no liability of any kind, whatsoever by granting this permit.

The location for which the right to exploration is granted on the said tract is several vein South dip.

In the event that anthracite coal is discovered during such 90 day period, and the person or persons to whom this permit is granted shall have the first opportunity to secure a mining lease on the premises.

This permit is issued on the assumption that the land on which the exploration is to be conducted is county owned land. No permission is granted to interfere with the other persons now mining on such county owned land.

NORTHUMBERLAND COURT COMMISSIONERS

EXHIBIT C

STRIPPING LEASE

THIS INDENTURE, made and concluded this 6th day of June, A.D., 1967, between COUNTY OF NORTHUMBERLAND, a municipal subdivision of the Commonwealth of Pennsylvania, by and through W. Fred Kohler, Fred E. Hoffman and Oscar Kehler, its duly elected and acting Board of County Commissioners hereby acting and contracting for said County and also as Trustee for the vari-

ous taxing districts interested in the hereinafter described land, hereinafter called lessor, First Party;

AND

Split Vein Coal Company
R.D. #1,
Paxinos, Penna.

hereinafter called Lessee, Second party.

WITNESSETH

Lessor does hereby grant unto Lessee, the right to strip mine and remove coal from the hereinafter described premises, for a term beginning on the 25th day of July, 1966 and ending on the Completion of lease, upon the conditions hereinafter set forth.

1. The land from which the coal is to be removed is described as follows, excepting and reserving therefrom, however, such rights as may have been acquired by any person, firm or corporation prior to the date of this lease:

This lease is for the right to strip the several veins on the Gray & Cleaver Tract (133 Acres) in Coal Township, Northumberland County, Pennsylvania.

Interference or encroachment on any other stripping lease or Independent Mining lease within the limits of this lease will not be permitted unless consented to by the stripping or mining lessee.

2. The payments hereinafter set forth and charged are and shall be construed to be a fixed, determined and established rental charge to be paid for the rights hereby granted, for the time and term designated in this lease agreement or sooner termination of the same, excepting the coal as and when removed from the ground shall become the property of LESSEE at and for the price and consideration hereinafter set forth.

3. LESSEE is granted the right to haul, convey and transport the raw coal stripped from the said premises over, through and across the above described premises and the highways appurtenent thereto and cover which

LESSOR has the right of ingress and egress for the purpose of marketing the coal so removed.

4. LESSEE shall not assign or transfer this lease contract or any part or portion thereof without the written consent and approval in writing of LESSOR having first been obtained.

5. LESSEE shall furnish, at his own expense and cost, all labor, material, plant tools and supplies, including gasoline and oil, shovels, grading equipment, trucks and any other necessary equipment and material necessary for the efficient operation and conduct of the strip mining of coal from the property herein described.

6. In consideration where of the said LESSEE covenants end agrees with the LESSOR to and as follows, to wit:

a. LESSEE shall and will pay the sum of thirty-five cents per gross ton of twenty two hundred forty (2240) pounds for each and every ton of raw coal stripped and removed from the demised premises. All such payments shall be paid to the LESSOR in weekly installments and each payment shall cover the preceding week. The payments shall be made to the LESSOR, County of Northumberland, at the office of the County commissioners at the Court House at Sunbury, Pennsylvania. It is understood that the term "raw coal", as used herein, shall mean the material taken from the ground prior to any preliminary cleaning and prior to the time when it shall be prepared in any manner whatsoever.

b. LESSOR reserves the right to increase the royalty hereunder by a 30 day written notice to the LESSEE, provided that such increase shall not be more than 5¢ a gross ton during the term of this agreement.

c. LESSEE on or before the tenth day of each month during the term and life of this Agreement, shall furnish LESSOR or its duly authorized agent, or representative, a statement of the daily gross tonnage of raw coal, stripped and/or removed from said tract of land during each and every day of the preceding calendar month; and such

statement shall be based upon records of all coal stripped and removed as aforesaid, kept by LESSEE and furnished to LESSOR. LESSEE hereby agrees to preserve and keep a duplicate wieght slip for each and every load of raw coal stripped and removed from the herein described land by himself or by his lessees and LESSOR through its duly authorized agents or representatives shall at all reasonable times have the right to examine and inspect such reports, records and weight slips.

d. LESSEE agrees to have all raw coal stripped and removed from the herein described lands, weighed at a scales by a duly licensed weightmaster of the Commonwealth of Pennsylvania, as shall be designated in writing by LESSOR.

e. LESSEE agrees that all coal stripped and removed from the herein described lands shall be delivered to such breakers, or preparation plants as may from time to time be designated in writing by LESSOR. Prior to any delivery of raw coal stripped or removed from the herein described land to a designated breaker or preparation plant, LESSEE shall obtain from the operator of the same and deliver to the LESSOR a written authority for the LESSOR, its representatives, engineers, agents or employees, from time to time to make a full and complete inspection of all books and records of said breaker or preparation plant pertaining to the delivery and preparation of coal at said plant during regular business hours.

f. It is expressly understood between the parties hereto, that LESSEE shall conduct his operations hereunder as an Independent Contractor and not as servant, agent or employee of the LESSOR, and any provisions in this lease agreement pertaining to supervision, inspection or instruction by LESSOR, its representatives, engineers, employees, or agents is not intended nor shall be construed to create a master and servant relationship between the parties hereto.

m. It is understood and agreed that, in cases where, in this agreement, the approval or direction of the said authorized agent is required, that such requirements are of

approval only and not of direction or management and that the said First Party shall not incur any responsibility by reason of acting as such authorized agent.

n. This lease is issued with the understanding that any persons now conducting deep mining operations or owning or operating utility lines on the premises shall be protected by LESSEE and his stripping operators. If the stripping operator desires to strip an area occupied by a deep mining operation or by utility lines, arrangements must first be made with the owner or operator of the deep mining operation or the utility line. These arrangements must be made by the stripping operator or else he must by-pass the deep mining operation or utility line so as not to disturb them.

o. It is understood that this Agreement shall in no way nullify or invalidate or impair the title of LESSOR, acquired at a Treasurer's Sale as aforesaid, and the payment of royalties hereunder shall in no wise work a redemption, either in whole or in part, of the said tract of land, nor shall it be construed as an abandonment to LESSOR in its land, but said tracts of land shall remain in the hands of the County Commissioners and on records in their office as unredeemed land.

p. It is hereby expressly understood between the parties hereto, the neither LESSOR nor W. Fred Kohler, Fred E. Hoffman and Oscar Kehler, individually nor in any capacity assume any liability hereunder except to accept and turn over and properly distribute among the various municipal subdivisions the proportionate share of said royalties as shall be due to the same under the terms of this agreement. And it is further understood between the parties hereto, that LESSOR and said W. Fred Kehler, Fred E. Hoffman and Oscar Kehler in entering into this agreement are acting only to the extent of their power and authority under the Laws of the Commonwealth of Pennsylvania, as the same is now declared or may be determined at any future time and are granting to LESSEE only such rights and privileges as they are able to do thereunder.

7. Regulating contract breaches and forfeitures, it is provided and agreed as follows:

a. That should the payments aforesaid be at any time in arrears and unpaid, the said LESSOR may enforce payment thereof, by distress upon the goods and chattels of the said LESSEE, as fully as is by law given to landlords to distrain and sell in ordinary cases of rent in arrears; and, the said LESSEE hereby waives the benefits of any law or laws exempting such goods and chattels, or any part thereof, from sale under such distress, or exemption laws.

b. That if LESSEE shall fail to make the payments herein provided upon the day and time when the same are due and payable, it may be lawful for the LESSOR to reenter upon the described premises and take possession and hold the same until all arrears of rent are paid and discharged by the LESSEE.

c. That for any breach of non-performance of any of the covenants, conditions or requirements contained herein, which on the part of said LESSEE, his successors and assigns, are to be performed, fulfilled and kept, this lease shall be and become absolutely void and of no effect, and it shall and may be lawful for the said LESSOR, his successors and assigns, to at once re-enter and take possession of the said described premises and appurtenances; and in such case the said LESSEE, for himself, his successors and assigns, hereby authorized any attorney of any court to record in the Commonwealth of Pennsylvania to appear for him and confess judgment in ejectment against him in favor of LESSOR, with a full release of all claims and damages against said attorney by reason of his so doing; and thereupon a writ of habere facies possessionen, with clause of fieri facias for costs, damages and rentals and payments in arrears, may be issued (without asking leave of Court) to put the said LESSOR in possession of the said promises, with the appurtenances, without stay of execution, certiorari, or appeal or other relief, in law or equity, PROVIDED HOWEVER, said judgment shall not prevent

said LESSOR from preceeding to recover any rent due by distress or otherwise and that said judgment shall not bar LESSOR from any action for damages for any loss sustained by any breach of this lease, but that the LESSOR may have and use any or all such remedies as herein provided if he may deem proper. The remedies herein provided may be enforced either separately or concurrently.

d. LESSEE hereby authorized and empowers any attorney of any court of record in Pennsylvania or elsewhere to appear for and to enter judgment against him for any and all rentals, and other sums agreed hereunder to be paid, which may be due and payable, whenever and as often as the same have not been paid, without stay of execution, until the same have been paid and with 10% added for collection fees and he also waives the right of inquisition on any real estate that may be levied upon to collect the said judgment or judgments and he does voluntarily condemn the same and authorized the Prothonotary to enter upon the fieri facies whenever same may be issued, his said voluntary condemnation, and he further agrees that said premises may be sold on a fieri facias and he hereby waives and releases all relief from any and all appraisement, stay or execution laws of any state now in force or hereafter to be passed; that these exemption conditions and provisions shall apply also to any other judgments in ejectment and habere facias possessionem thereon or any other judgments or actions undertaken by LESSOR to enforce the provisions, covenants, and agreements under this lease.

e. LESSEE shall deliver up peaceable possession of the said premises to LESSOR, upon the expiration or sooner termination of this lease.

9. It is hereby expressly understood between the parties the LESSOR may terminate this agreement completely and fully and without any liability upon it or any further recourse against it, upon thirty days written notice given to LESSEE or by posting the same upon the lands herein-above mentioned.

IN WITNESS WHEREOF, the Parties have hereunto set their hands and seals this 9th day of June, 1967.

COUNTY OF NORTHUMBERLAND

Chief Clerk

Commissioners

WITNESSES:

EXHIBIT "D"

EQUIPMENT	*PURCHASE PRICE*
66 Mack Tractor	$ 19,057.50
1964 Cadillac (Used) 75% Business	3,294.07
1960 Dump Truck (Used)	4,950.00
26 A St. Dump T/A 4408	4,745.68
Radios & Installation	987.11
Motors & Coal Scoop	1,844.75
Rolls	2,450.00
Space Heater & Speed Reducer	536.10
Trailer	800.00
Trailer	6,009.48
Trailer (Used)	500.00
Trailer	6,810.62
Truck (Used)	7,129.67
Truck Diesel	13,344.69
Mack Truck—Trailer Rig	18,000.00
Pick-Up Truck	3,524.30
Tractor	16,700.00
Truck—Studebaker	1,700.00
Truck—White	2,000.00
Truck—Fuel (Used)	450.00
Breaker	22,000.00
Coal Hole	1,000.00
Loader	10,943.00
Loader (Used)	8,790.00
Loader	11,162.00
Coal Hole Equipment	$ 3,435.00
Crusher	2,500.00

EQUIPMENT	*PURCHASE PRICE*
Hoist, Generators, Pumps, etc.	4,000.00
Compressor	2,000.00
Compressor	2,225.30
Generator	3,338.16
Generator	9,275.34
Conveyor Chains	5,000.00
Conveyor Chains	4,665.00
Pipe & Pumps	1,218.00
Coal Washing Table	312.15
Power Saws & Motor	207.50
Fan	200.00
Overhaul Allis-Chalmer	3,092.26
Overhaul Loader	3,504.17
Conveyor Chain	1,053.60
Conveyor	2,500.00
Pump Motor Pipes	1,385.20
Steel Tracks & Carts	1,789.15
Payloader	13,000.00
Rolls	2,200.00
Breaker Stoker	2,115.35
Garage—Cinder Block	8,577.23
Drilling Water Well	1,042.00
Water Pump & Installation	1,810.00
Welder	$ 2,250.00
Batteries	3,620.64
Cat. 950 Traxcavator	24,078.76
Shovel #8105	18,500.00
Gould Pump	2,500.00
Cat. D.9 Tractor (Used)	30,012.50
Air Compressor	2,500.00
Power Shovel	11,000.00
Bulldozer	12,000.00
Conveyor Chain	1,701.00
Wench (Used)	600.00
Screening Plant	11,519.80
Electric Sets	2,832.50
Conveyor Chain (Used)	450.00
Quaker State Pump	424.25
TOTAL	$373,163,83

IN THE UNITED STATES COURT OF CLAIMS

No. 403-75

ELWOOD SWANK AND RITA SWANK, PLAINTIFFS

v.

THE UNITED STATES, DEFENDANT

SUPPLEMENTAL STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, through their respective counsel, that the following facts may be accepted as true for the purpose of this case. The parties reserve the right to argue the relevance of or materiality of any matter contained herein.

1. On October 26, 1962, John Stanley Perles, a sole proprietor, entered into a Deep Mining Lease for the extraction of anthracite coal with the Commissioners of the County of Northumberland, Pennsylvania. Taxpayer did not enter into this lease. A true and correct copy of the said lease is attached hereto as Exhibit "E" and made a part hereof. On July 16, 1963, the said John Stanley Perles entered into a partnership agreement with Taxpayer for the mining, marketing and sale of anthracite coal. A true and correct copy of the said partnership agreement is attached hereto as Exhibit "F".

2. The property described in the Deep Mining Leases (October 24, 1964, and October 26, 1966) and the Stripping Lease (June 6, 1967) here in suite, was not redeemed under Pennsylvania redemption laws by payment of overdue taxes by a party in interest.

LLOYD R. PERSUN
Attorney for Plaintiff

M. CARR FERGUSON
Assistant Attorney General

JAMES L. MALONE III
Attorneys for Defendant

FINDINGS OF FACT

1. Plaintiffs are Elwood and Rita Swank, husband and wife, residing at R.D. No. 1, Box 85 D, Paxinos, Pennsylvania. They owned and operated a sole proprietorship t/a Split Vein Coal Company throughout 1966 and during the first 4 months of 1967. On May 1, 1967, the assets of the sole proprietorship were transferred to Split Vein Coal Company, Inc., in a tax-free incorporation pursuant to Section 351 of the Internal Revenue Code of 1954, as amended. Hereafter the term plaintiff shall mean both husband and wife, or their sole proprietorship.

2. Plaintiff timely filed joint 1966 and 1967 Federal individual income tax returns with the District Director, Internal Revenue Service, Mid-Atlantic Region, in Philadelphia, Pennsylvania, and paid the tax shown to be due thereon.

3. In his joint 1966 and 1967 Federal individual income tax returns, plaintiff claimed as a deduction from ordinary income a deduction for depletion of coal resources in which he claimed an economic interest in 1966 and in the first third of 1967.

4. After audit, the government disallowed the deductions referred to in paragraph 3 above and, as a result thereof, assessed deficiencies against plaintiff for the years 1966 and 1967 in the aggregate amount of $30,587.84 which was paid to the government under protest, together with assessed interest in the aggregate amount of $3,663.

5. On or about February 25, 1974, plaintiff filed timely claims for refund for the years 1966 and 1967. The claims for refund were disallowed. Plaintiff timely filed this appeal.

6. At all times material hereto plaintiff was engaged in mining and strip mining anthracite coal as lessee of various mining tracts in the Northumberland County, Pennsylvania area. Plaintiff strip mined and deep mined only from leased coal lands. He purchased and owned the machinery and equipment used in his mining operations,

and took depreciation deductions on such machinery and equipment. See finding 21, *infra*.

7. In deep mining the plaintiff excavated shafts through the overburden into veins of coal. He then conveyed his employed miners in buggies on rails through the shaft, to the coal face, where, using explosives, picks and shovels they extracted coal which was carried to the surface on the railed buggies. Thence it was trucked into plaintiff's breaker where, as in the case of strip mined coal, it was cleaned, sorted, sold to the general public, and carried by plaintiff's trucks to plaintiff's siding (see finding 21) where it was loaded onto railroad cars. A breaker (sometimes "tipple") removes the slate and rock and then sorts the coal into seven sizes for public sale at prices varying with its quality and prevailing market conditions.

8. During the tax years in dispute Northumberland County, Pennsylvania, owned over 17,500 acres of coal property in the county which it had acquired at sales for delinquent taxes. Two of the properties had been leased, separately, to Edward Gusick, and to the Kozar Coal Company, as deep mine operations. These two leases were cancelled on October 24, 1964 and October 26, 1966, respectively, and immediately re-leased to plaintiff because plaintiff had bought out the interests of Gusick (for $12,085, including the assumption of remaining payments of $5,085.50 on generating equipment, and the balance for Gusick's existing excavation on the property) and of Kozar (for $7,000, including equipment and existing excavation). Neither of the two properties had been redeemed by their former owners from the county by payment of tax arrears under Pennsylvania laws.

9. During 1966 and 1967 the plaintiff deep mined coal under the lease of October 24, 1964, referred to in finding 8. The lease was terminated in May 1968 when heavy rainfall caused a mountain slide which closed the mine. Plaintiff never extracted coal under the lease of October 26, 1966, and it was terminated for cause in November 1969 due to plaintiff's failure to mine.

10. During 1966 and 1967 the plaintiff strip mined coal

from land he leased on July 25, 1966, from Northumberland County. The property had not been previously mined. He strip mined by using his power shovel to remove the overburdening soil and terrain covering the underlying coal (hereinafter the "overburden"). The power shovel then "stripped" the exposed coal from the earth's surface and placed it in large piles next to loaders. The piled coal then was conveyed by the loaders into trucks which hauled the coal from the leased lands to a breaker, where the coal was cleaned and sorted. From the breaker, the coal was sold to the general public on the open market.

11. Plaintiff paid Northumberland County royalties of $7,545.10 in 1966 and $6,854.05 in 1967 on coal which was mined under the leases referred to in findings 8 and 10. The royalties were fixed in the leases at 35 cents per gross ton of coal removed. The county would receive weigh slips from the breaker verifying the tonnage sold, and plaintiff would remit to the county the royalties from each sale.

12. Each of the three leases between plaintiff and Northumberland County referred to in findings 8 and 10 herein, which was good until terminated, contained several provisions for its automatic termination in the event of sale of the lands by the county[1] or redemption of the lands by tax delinquent former owners, or the lessee's failure to mine and remove coal for 30 consecutive days unless due to abnormal conditions. Other clauses provided for automatic cancellation of the leases for violation of any of their terms. Finally, a clause in each lease provided the following or its substantial equivalent:

> It is hereby expressly understood between the parties hereto that LESSOR may terminate this agreement completely and fully without liability upon it or any further recourse against it, upon thirty days written notice given to MINER or by posting the same upon the lands hereinabove mentioned.

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[1] Northumberland County has never sold a fee interest in lands acquired for unpaid taxes, for fear of criticism over selling such land if valuable minerals were later discovered.

A similar or identical provision for 30-day termination notice was included in all coal mining leases granted by Northumberland County From January 1, 1956 to May 31, 1969. It is reasonable to construe the clause as authority by Northumberland County to terminate the lease without cause on 30 days notice. However, the leases were "administered" leases, that is, they were standard forms with "boiler-plate" clauses prepared by the lessor which were not subject to negotiation.

13. The language of the deep mining leases referred to in finding 8 is identical to the language of the lease involved in *Whitmer* v. *Comm'r.*, 28 T.C.M. 1480 (1969), *aff'd.* 443 F.2d 170 (C.A. 3 Cir. 1971), except for the name of the lessee, description of the property, and the termination date.

14. Taxpayer was under no obligation to sell the coal to the lessor or to any other party. He could sell the coal to whomever he pleased and at whatever price he could obtain.

15. (a) Since 1956 it has been the publicly announced policy that the Northumberland County Commissioners would never terminate a mining lease except for the lessee's failure to mine for an unreasonably long period of time, or for the lessee's failure to pay royalties, or for the lessee's cheating on the royalty. Every lessee received the same form lease from the county, and in each case it was with the stipulation that the county would not cancel except for cause. The reason for this was that the county commissioners recognized that they could not expect an independent miner to invest time and considerable capital in the development of county coal lands without some assurance that, if he conformed to the terms of the lease, he would be allowed to recover his investment and make a profit on his mine.

(b) This policy was based on various charges made during the primary election for Northumberland county commissioners held in the early 1950's to the effect that coal leases were being granted on a basis of political favoritism. As a result of these charges the incumbent

county commissioners were defeated in their bids for reelection. For this reason the county commissioners would not enter into leases without a 30-day termination clause so that there might be no question of political favoritism or criticism by the public of the actions of the county commissioners in leasing coal lands.

(c) Statements to the effect that Northumberland County would not terminate a lease except for cause were made to various individual mine operators (including taxpayer), in public meetings of the commissioners, and reported in the press. However no assurance was given that the county commissioners *could* not cancel a lease without cause.

16. Interests in county mining leases and mining operations were frequently bought and sold by independent miners. The county's policy in such cases was to either transfer the lease, or to prepare a new lease for the future lessee. The county received no consideration for the transfer of an old lease to a new lease. Nor was it concerned if the present lessee received consideration for the transfer from the future lessee.

17. Plaintiff is known as an independent coal miner. He is so classified because the coal mining operations of independent coal miners are generally small operations as compared to the large corporate operations which at one time flourished in the anthracite coal areas of Northumberland County. Independent coal miners produce coal from public coal lands, and the operations are under the active direction of the owners of the mine. As such, plaintiff belongs to the Independent Miners, Breakermen and Truckers Association of Shamokin, Pennsylvania, an association of similarly situated miners and other businessmen engaged in the mining, processing, trucking and sale of anthracite coal.

18. Plaintiff had 14 employees in both 1966 and 1967.

19. Plaintiff spent $6,500 to build access roads to his strip mine from the public highways. This expense was depreciated on plaintiff's Federal income tax returns.

20. Plaintiff's breaker referred to in finding 7, *supra*, was located 5 or 6 miles away from the mines involved in this proceeding. It was purchased by plaintiff about 1959 for $22,000, and was improved by plaintiff by 1966 at a cost of $96,477.27, according to his testimony.[2]

21. In either 1962 or 1963 plaintiff, at a cost of $10,000, purchased a railroad siding located approximately 1,000 feet from his breaker. This railroad siding was connected to the Penn Central Transportation Company railroad line and, during the years in suit, was used in plaintiff's mining operations. During the years in suit plaintiff leased the land where the siding was located for a rental of $600 per year.

22. The parties stipulated that plaintiff purchased equipment for $373,163.83 for use at relevant times in the mining operations under the leases referred to in these findings. However, the evidence indicates that this equipment was not used exclusively for plaintiff's mining operations at the mines which are the subject of this suit. To an unascertainable extent the equipment listed was also used in connection with the processing of coal purchased by plaintiff from other mines, as well as in plaintiff's separate trucking businesses. Thus, plaintiff's 1967 income tax return, which states his occupation as "mining" and "trucking", claims depreciation of $5,705 for the mining business, and $11,860.88 for the trucking business, the one being for 4 months of 1967 and the other 8 months. The depreciation schedule claiming the depreciation of equipment used in the trucking business shows that the acquisition cost of the depreciated equipment was $139,827.71, which would infer that at that time plaintiff's depreciable equipment used in the mining business had a cost basis of $233,336.12 ($373,163.83—$139,827.71). According to the depreciation schedules all of the equipment

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[2]The acquisition cost of the breaker of $22,000 in January 1959 is listed in the depreciation schedule attached to plaintiff's 1967 tax return, but not the improvements of $96,477.27. It is assumed that normally such improvements, if made, would have been capitalized and depreciated, but if so it does not appear in the 1967 schedule.

depreciated had been acquired at various times from January 1959 through April 1967. In other words, it would be misleading to interpret the parties' stipulation to mean that plaintiff purchased and used $373,163.83 worth of equipment exclusively for use in connection with the mining and sale of coal under the leases involved in this suit.

CONCLUSION OF LAW

Upon the trial judge's findings and opinion, which are adopted by the court, the court concludes as a matter of law that plaintiff is entitled to recover taxes and interest assessed, plus interest as provided by law. The amount of plaintiff's recovery should be determined pursuant to Rule 131(c)(2).

GENERAL

BLACK HAWK COAL CORPORATION, INC.
DOING BUSINESS UNDER THE NAME OF
BLACK HAWK COAL COMPANY, INC.

v.

THE UNITED STATES

Income taxes

January 24 1977
5 COPIES OF PETITION TO DEFENDANT.
$164,237.43
Feds Creek, KY and
Grundy, VA

GENERAL

Jan 24 1977	Filing fee of $10 paid by plaintiff.
Feb 9 1977	Notice of reference to Trial Judge C. Murray Bernhardt filed. Copy to parties.
Mar 25 1977	Defendant's answer filed. Copies (5) to atty.
Oct 31 1978	Stipulation of facts filed by defendant. Copy to atty. (2)
Nov 1 1978	Trial Judge's memorandum report returning case to court on stipulation facts filed. Copies to parties.
Nov 30 1978	Plaintiff's motion for extension of time (to February 14, 1979) to fill its brief filed. Copies (2) to deft. ALLOWED DEC 1 1978.
Feb 23 1979	Plaintiff's brief filed. Copies (5) to deft. (BLOC).
Mar 26 1979	Defendant's brief filed. Copies (5) to atty.
Apr 16 1979	Plaintiff's reply brief filed. Copies (5) to deft.
May 15 1979	See 400-77 for defendant's motion or order directing consolidation.
Jun 4 1979	See 400-77 for argument and submission.

Jul 18 1979	See 403-75 for Court Opinion.
Dec 3 1979	Stipulation for entry of judgment filed. Copies (2) to atty.
Dec 4 1979	Trial Judge's memorandum report for judgment filed. Copy to parties.
Dec 7 1979	Court filed order entering judgment for plaintiff in the sum of $164,141.03 plus statutory interest. Copy to parties.
Dec 7 1979	Certified transcript of judgment mailed to attorney of record.

IN THE UNITED STATES COURT OF CLAIMS

No. 49-77

BLACK HAWK COAL CORPORATION, INC.
DOING BUSINESS UNDER THE NAME OF
BLACK HAWK COAL COMPANY, INC., PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

PETITION

TO THE HONORABLE THE CHIEF JUDGE AND THE ASSOCIATE JUDGES OF THE COURT OF CLAIMS:

1. Plaintiff, Black Hawk Coal Corporation, Inc., is a corporation chartered under the laws of the Commonwealth of Kentucky on April 7, 1964, with its registered office at Feds Creek, Kentucky and its business office in Grundy, Virginia. Following its incorporation the company transacted its business under the name of Black Hawk Coal Company, Inc. Said corporation was authorized to issue 250 shares of common stock with a par value of $100.00 per share. One hundred shares were issued and outstanding during the calendar years ending December 31, 1970, December 31, 1971 and December 31, 1972. The following is a list of the shareholders and the number of shares owned by each:

E. M. Bane, Sr.	18 shares
E. R. Bane	1 share
Eugene M. Bane, Jr.	40 shares
Betty M. Worley	40 shares
William D. Bane	1 share
Total	100 shares

2. Said corporation under the name of Black Hawk Coal Company, Inc., filed its income tax returns for the calendar years ending December 31, 1970 and December 31, 1971, with the Internal Revenue Service, Cincinnati, Ohio and its December 31, 1972 return with the Internal Revenue Service Center, Memphis, Tennessee, and paid the

tax shown thereon to be owing in the respective amounts of $57,236.65, $61,296.84, and $42,461.31.

3. This action is brought pursuant to Sections 1346 and 1491 of the Judicial Code (28 U.S.C.A. Sections 1346 and 1491) against the United States of America, as Defendant.

4. During the calendar years ending December 31, 1970, 1971, and 1972, Plaintiff, Black Hawk Coal Corporation, Inc., was engaged in the business of mining and producing coal. Said company operated under a Lease dated the 20th day of February, 1964, between Kentland Coal & Coke Company Division of the Berwind-White Coal Mining Company, a Pennsylvania corporation, Lessor, and Eugene M. Bane of Grundy, Virginia, Lessee. Said Lease was assigned by E. M. Bane to the said Black Hawk Coal Corporation, Inc., pursuant to the "Initial Plans for the Organization of Black Hawk Coal Corporation" as shown in the Minute Book of said corporation, dated February 21, 1964.

5. Said Lease granted to the Lessee the exclusive right to mine to exhausion, subject to the terms of said Lease, certain specific seams of coal under seven parcels of land in Pike County, Kentucky.

6. In consideration thereof the Lessee agreed to pay to the Lessor as rent the sum of Five Thousand and No/100 Dollars ($5,000.00) per year in monthly installments and a tonnage royalty of twenty-five cents ($.25) per ton for all coal mined from the leased premises, to be credited against the said rental.

7. As a result of the Lease Agreement and assignment hereinabove referred to, the said Black Hawk Coal Corporation, Inc., acquired an economic interest in the coal which it produced under said Lease Agreement and was entitled to percentage depletion under Sections 611 and 613 of the Internal Revenue Code of 1954.

8. No claim for percentage depletion on the coal extracted has been claimed by the Lessor or by any other person, firm or corporation. The sole claimant to said percentage depletion deduction was Black Hawk Coal Corporation, Inc.

9. Upon examination, the Commissioner of Internal Revenue erroneously disallowed the depletion deduction claimed by the Plaintiff.

10. On or about the 28th day of March, 1975, Plaintiff, Black Hawk Coal Corporation, Inc. paid by three checks in the name of Black Hawk Coal Co., Inc. the deficiency resulting from the disallowance of depletion for the calendar years ending December 31, 1970, December 31, 1971, and December 31, 1972, in the amounts of $67,128.52, $60,329.38, and $37,199.53 respectively, which included assessed interest as provided by law.

11. On or about June 2, 1975, Plaintiff, Black Hawk Coal Corporation, Inc., filed separate claims for refunds in the name of Black Hawk Coal Company, Inc. for the calendar years ending December 31, 1970, December 31, 1971, and December 31, 1972, and mailed same to the Internal Revenue Service Center, 3131 Democrat Road, Memphis, Tennessee, in the respective amounts of $54,026.98, $51,018.50, and $32,719.89*, plus assessed interest in the amounts of $13,101.54, $9,310.88, and $4,059.64 respectively. These claims were based on the fact that Black Hawk Coal Corporation, Inc. had the economic interest in the coal in place and was entitled to the depletion claimed for the calendar years ending December 31, 1970, December 31, 1971, and December 31, 1972.

12. The District Director of Internal Revenue on January 7, 1976, by three separate letters addressed to Black Hawk Coal Company, Inc., Grundy, Virginia, and sent by certified mail, officially disallowed the claims for refund for the tax period ending December 31, 1970, in the amount of $54,026.98, for the tax period ended December 31, 1971, in the amount of $51,018.50; and for the tax period ending December 31, 1972, in the amount of $32,719.89 and the interest paid thereon.

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* The taxpayer concedes the adjustment to interest income which increased taxpayer's taxable income in the amount of $875.00.

13. By reason of the Commissioner's failure to allow claims for refund of Plaintiff for the years hereinafter set out, the following amounts are now wrongfully withheld from the Plaintiff without its consent and against its will.

Year Ended	*Amount*	*Interest*	*Total*
December 31, 1970	$54,026.98	$13,101.54	$67,128.52
December 31, 1971	$51,018.50	$9,310.88	$60,329.38
December 31, 1972	$32,719.09	$4,059.64	$36,779.53

14. The amounts claimed represent the additional income taxes and interest paid by the Plaintiff to the District Director of Internal Revenue as a result of the disallowance of the claimed percentage depletion to Black Hawk Coal Corporation, Inc., for the said calendar years ending December 31, 1970, December 31, 1971, and December 31, 1972.

15. No action has been had on said claims in the United States Congress, or any of the Departments of the government, nor in any other Judicial Proceeding, including the Tax Court of the United States; no other person, firm or corporation other than Plaintiff is the owner thereof or interested therein; no assignment or transfer of these claims or any part thereof or interests therein has been made. Plaintiff is justly entitled to the amounts herein claimed from the United States after allowing all just credits and off-sets. The Plaintiff has at all time borne true faith and allegiance to the Government of the United States and has not in any way voluntarily aided, abetted, or given encouragement against said Government.

WHEREFORE, Plaintiff, Black Hawk Coal Corporation, Inc., doing business under the name of Black Hawk Coal Company, Inc., asks judgment against the United States of America in the sum of $67,128.52 for the tax period ended December 31, 1970; $60,329.38 for the tax period ended December 31, 1971; and $36,779.53 for the tax period ended December 31, 1972, making a total sum due and payable for said three years of $164,237.43, together

with costs and interest to the extent allowed by law, and for such other and further relief as may to this Honorable Court seem just and proper.

LeRoy Katz
Katz, Kantor, Katz, Perkins &
Cameron
P. O. Box 727
Bluefield, WV 24701
Attorney for Plaintiff

IN THE UNITED STATES COURT OF CLAIMS

No. 49-77

BLACK HAWK COAL CORPORATION, INC., DOING BUSINESS UNDER THE NAME OF BLACK HAWK COAL COMPANY,

Plaintiff

v.

THE UNITED STATES,

Defendant

ANSWER

The defendant, the United States, answers the plaintiff's petition by denying each and every allegation contained therein which has not been admitted, qualified, or expressly referred to below.

The defendant further:

1. Admits that the plaintiff, Black Hawk Coal Corporation, Inc., is a corporation chartered under the laws of the Commonwealth of Kentucky, but states that its trial attorney is presently without sufficient knowledge or information to either admit or deny the remaining allegations contained in paragraph 1.

2. Admits the allegations contained in paragraph 2.

3. States that jurisdiction is conferred upon this Court by virtue of 28 U.S.C. §1491.

4. Admits the allegations contained in the first two sentences of paragraph 4, but states that its attorney is presently without sufficient knowledge or information to either admit or deny the allegations contained in the last sentence of paragraph 4.

5. Denies the allegations contained in paragraph 5.

6. States that the agreement, dated February 20, 1964, betwen Kentland Coal and Coke Company Division of the Berwind-White Coal Mining Company, lessor, and Eugene M. Bane, lessee, speaks for itself.

7. Denies the allegations contained in paragraph 7.

8. States that its attorney is presently without sufficient knowledge or information to either admit or deny the allegations contained in paragraph 8.

9. Admits that the Commissioner of Internal Revenue disallowed the depletion deduction claimed by the plaintiff, but denies that such disallowance was erroneous.

10. States that the plaintiff was timely and properly assessed on April 15, 1975, additional tax and interest for its 1970, 1971, and 1972 tax years as follows:

Year	*Tax*	*Interest*	*Total*
1970	$54,026.98	$13,117.45	$67,144.43
1971	$51,018.50	$9,325.90	$60,344.40
1972	$33,139.89	$4,059.64	$37,199.53

In respect to 1970, payments of $67,128.52 (received April 2, 1975) and $15.91 (received May 7, 1975) were made in satisfaction of the plaintiff's 1970 tax liabilities. In respect to 1971, payments of $60,329.38 (received April 2, 1975) and $15.02 (received May 7, 1975) were made in satisfaction of the plaintiff's 1971 tax liabilities. In respect to 1972, a payment of $37,199.53 (received April 2, 1975) was made in satisfaction of the plaintiff's 1972 tax liability.

11. States that the plaintiff filed three claims for refund (Forms 843) dated June 2, 1975, one for each of the three years in question, as follows:

Year	*Date Received*	*Amount (Tax)*
1970	June 9, 1975	$54,026.98
1971	June 5, 1975	$51,018.50
1972	June 11, 1975	$32,719.89

Defendant denies the grounds upon which those claims for refund rest.

12. Admits the allegations contained in paragraph 12.

13. Denies the allegations contained in paragraph 13.

14. Admits the allegations contained in paragraph 14.

15. States that its attorney is presently without sufficient knowledge or information to either admit or deny the allegations contained in paragraph 15, except denies that the plaintiff is justly entitled to the amounts herein claimed from the United States after allowing all just credits and offsets.

WHEREFORE, defendant prays that the petition be dismissed with costs assessed against the plaintiff.

Respectfully submitted,

MYRON C. BAUM
Acting Assistant Attorney General

C. PATRICK DERDENGER
Attorney

MARCH 25, 1977

IN THE UNITED STATES COURT OF CLAIMS

No. 49-77

BLACK HAWK COAL CORPORATION, INC.

DOING BUSINESS UNDER THE NAME OF
BLACK HAWK COAL COMPANY, INC.,

Plaintiff

v.

UNITED STATES OF AMERICA,

Defendant

STIPULATION OF FACTS

It is hereby agreed and stipulated between the parties hereto that, for the purpose of this case only, the following may be accepted and adopted as facts and all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part hereof:

1. Plaintiff, Black Hawk Coal Corporation, Inc., is a corporation chartered under the laws of the Commonwealth of Kentucky on April 7, 1964, with its registered office at Feds Creek, Kentucky, and its business office in Grundy, Virginia. Said corporation was authorized to issue 250 shares of common stock with a par value of $100.00 per share. One hundred shares were issued and outstanding during the calendar years ending December 31, 1970, December 31, 1971 and December 31, 1972. The following is a list of the shareholders and the number of shares owned by each:

E.M. Bane, Sr.	18
E.R. Bane	1
Eugene M. Bane, Jr.	40
Betty M. Worley	40
William D. Bane	1
TOTAL	100

2. Said corporation under the name of Black Hawk Coal Company, Inc., filed its income tax returns for the calendar years ending December 31, 1970, and December 31, 1971, with the Internal Revenue Service, Cincinnati, Ohio, and its December 31, 1972, return with the Internal Revenue Service Center, Memphis, Tennessee, and paid the tax shown thereon to be owing in the respective amounts of $57,236.65, $61,296.84 and $42,461.31. True copies of the returns are attached hereto as Exhibits No. 1, 2 and 3, respectively.

3. The plaintiff corporation during the years involved, was engaged in the drift mining of coal under an agreement entitled "Agreement of Lease" dated February 20, 1964. Said agreement was between Kentland Coal & Coke Company Division of the Berwind-White Coal Mining Company, a Pennsylvania corporation, Lessor and Eugene M. Bane of Grundy, Virginia, Lessee. A true copy of said Lease is attached hereto as Exhibit No. 4. Said Lease was assigned by E.M. Bane to the said Black Hawk Coal Corporation, Inc., pursuant to the "Initial Plans for the Organization of Black Hawk Coal Corporation," as shown in the Minute Book of said corporation, dated February 21, 1974. A copy of said "Initial Plans for the Organization of Black Hawk Coal Corporation" is attached hereto as Exhibit No. 5.

4. The plaintiff corporation has mined coal continuously from said property from 1964 through the taxable years herein involved.

5. The Lease Agreement hereinabove referred to is attached hereto as Exhibit No. 4. The copy of Exhibit No. 4 has thereon certain lines which have been underlined, on pages 3, 5, 6 and 8. Also appearing on page 3 is a star on the left-hand side and an arrow on page 8 of said Lease. None of the underlining, the star nor the arrow have any bearing upon the Agreement and are not to be considered in the examination of this Lease, and the interpretation thereof by the Court.

6. The plaintiff corporation was engaged, during the years in issue, in the drift mining of said coal, pursuant to

the Agreement of Lease, hereinabove referred to. The actual mining of the coal was done by independent contractors employed by the plaintiff corporation for this purpose. Drift mining of coal is an underground mining operation in which a horizontal coal seam is reached by clearing away part of the mountainside with a bulldozer, by a process called "facing-up" the coal seam. Two parallel tunnels are made into the coal seam, one for ventilation and the other for working space in removal of coal. The coal is removed as the drift mine is driven into the mountain following the seam of coal. The roof of the mine is supported by leaving pillars of coal in place and erecting wood supports. Under the oral agremeent, the mining contractor provided the labor and supervision necessary to mine the coal and to transport the mined coal to the tipple site for a fixed dollar amount per ton. The price per ton paid to the contractor was not dependent upon the sales price of the coal. The trucks used to haul the coal from the mine site to the tipple were furnished by the mining contractors. Plaintiff corporation furnished the majority of the mining equipment needed by the mining contractors to extract the coal, constructed and maintained the access roads and built the power lines to the mining operations.

7. When the coal has been removed from the mine, it is loaded into trucks and hauled approximately five miles to a tipple located on land owned by The Flannary Coal & Land Company, a partnership, consisting of E.M. Bane, J.W. Garside, E.B. Woodruff and John W. Garside. The tipple, located on said land, is known as the Apache Tipple and is owned by the same partners as The Flannary Coal & Land Company. The tipple consists of a preparation plant which cleans the coal prior to its sale to customers. When the coal is delivered to the tipple, by the trucks, it is weighed on a truck scale and Apache pays Black Hawk Coal Company for the coal on a per ton basis. After the coal is cleaned, it is dumped into railroad cars and then sold on the open market through a commission sales agent, the Woodruff Coal Company of Kalamazoo, Michigan.

8. The plaintiff corporation was free to sell its coal to

anyone and was not obligated to sell it to Apache Coal Company (or Flannary Coal Company) or to Kentland Coal & Coke Company, the Lessor, or its sales agency. In fact, none of said coal was sold to the Lessor or its sales agency. All of plaintiff's coal was sold to Appache (or Flannary), and the said Woodruff Coal Company of Kalamazoo, Michigan, then sold the coal on the open market to its customers. All coal feasible to mine has been extracted with mining operations ceasing in 1976.

9. All operating expenses of Black Hawk Coal Company, Inc., other than capital expenditures recoverable by depreciation, including the fees paid to the independent mining contractors, the rent or royalties paid under the agreements entitled "Agreement of Lease" and the commissions paid to sales agents were taken as deductions from gross income on the tax returns described herein as Exhibits 1, 2 and 3.

10. No claim for percentage depletion has been made by Kentland Coal & Coke Company, division of the Berwind-White Coal Mining Company, under the agreement entitled "Agreement of Lease" with Black Hawk Coal Company, Inc. No claim for percentage depletion on the coal extracted has been made by the independent mining contractors. The sole claimant to the percentage depletion deduction is the Black Hawk Coal Company, Inc.

11. Upon examination, the Commissioner of Internal Revenue disallowed the percentage depletion deduction claimed by Black Hawk Coal Company, Inc., resulting in the assessment of deficiencies in income tax against Black Hawk Coal Company, Inc.

12. Plaintiff, Black Hawk Coal Corporation, Inc., timely paid in the name of Black Hawk Coal Company, Inc., the deficiency resulting from the disallowance of depletion for the calendar years ending December 31, 1970, December 31, 1971, and December 31, 1972, in the amounts of $67,144.43, $60,344.40 and $37,199.53, respectively, which included interest as provided by law.

13. Plaintiff, Black Hawk Coal Corporation, Inc., timely

filed separate claims for refunds in the name of Black Hawk Coal Company, Inc., as follows:

Year Ended	*Amount*	*Interest*	*Total*
December 31, 1970	$54,026.98	$13,101.54	$67,128.52
December 31, 1971	$51,018.50	$ 9,310.88	$60,329.38
December 31, 1972	$32,719.89*	$ 4,059.64	$36,199.53
			163,657.43

14. The Commissioner of Internal Revenue has disallowed all claims for refund by statutory notices sent to the plaintiff dated January 7, 1976.

15. All requirements for jurisdiction of the Court have been satisfied. In the event the plaintiff is entitled to recover, the amount of recovery will be computed by the Internal Revenue Service subject to verification by the plaintiff.

16. The issue to be determined by this Court is whether the inclusion of the 30-day termination clause in the "Agreement of Lease," described in Stipulation Paragraph 3, *supra*, prevents the plaintiff from claiming the percentage depletion deduction permitted by the Internal Revenue Code.

17. This Court decided the identical issue in *Bakertown Coal Company, Inc. v. The United States*, No. 53-69, decided January 13, 1972, holding that the Lessees in that case were entitled to the percentage depletion deduction.

18. Lessor in *Bakertown*, *supra*, is the same Lessor as in the instant case. True copies of the Leases in question in *Bakertown* are attached hereto as Exhibits 6, 7 and 8.

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* The taxpayer conceded the adjustment to interest income which increased taxpayer's taxable income in the amount of $875.00.

Respectfully submitted,

LEROY KATZ
Attorney for Plaintiff

Assistant Attorney General

Attorney for Defendant

Date

EXHIBIT 4

THIS AGREEMENT OF LEASE, made this the 20th day of February, 1964, by and between KENTLAND COAL AND COKE COMPANY DIVISION of THE BERWIND-WHITE COAL MINING COMPANY, A Pennsylvania corporation, hereinafter called LESSOR, party of the first part, and EUGENE M. BANE of Grundy, Virginia, hereinafter called LESSEE, party of the second part.

WITNESSETH:

That for and in consideration of the rents, royalties and other moneys to be paid by LESSEE unto LESSOR, as well as for and in consideration of the covenants and agreements hereinafter contained on the part of the LESSEE to be kept, performed and observed, LESSOR does hereby give and grant unto LESSEE, under and subject to all the exceptions, reservations, terms and conditions hereinafter contained and for the period of time hereinafter mentioned, the exclusive right and privilege to mine and take away the Feds Creek (Clintwood) Seam of coal upon and underlying certain tracts or boundaries of land situate as follows, to-wit:

Part of Kentland Tract	464	Matilda J. Fuller	Mineral	11.94 A
Part of Kentland Tract	467	Elijah Fuller	Mineral	13.31 "
Part of Kentland Tract	468	Matilda J. Estep	Mineral	9.18 "
Part of Kentland Tract	472	Thornsbury & Jones	Mineral	27.78 "
Part of Kentland Tract	501	George W. Dotson	Mineral	41.55 "

Part of Kentland Tract	529	David Griffey, Sr.	Mineral	37.88"
Part of Kentland Tract	530	James Griffey	Mineral	37.65"

being those parts of tracts lying on the point ridge between Road Fork and Dicks Fork of Feds Creek and Hen Roost Fork of said Dicks Fork, said Feds Creek being a tributary of Levisa Fork of Big Sandy River, in Pike County, Kentucky, said leased area being colored red as to mineral and outlined in green on whiteprint map attached hereto and made a part hereof, bearing the following title and legend:

KENTLAND COAL AND COKE COMPANY
DIVISION OF THE BERWIND-WHITE COAL
MINING COMPANY
PIKE COUNTY, KENTUCKY

February 10, 1964 Scale 1" = 1000'

LEGEND

Mineral—Area of Feds Creek (Clintwood) Seam of Coal
Proposed To Be Leased To Eugene M. Bane

LESSEE agrees to have the outcrop of said Feds Creek (or Clintwood) seam, also all property lines above the outcrop of said seam, accurately, surveyed within six months from date hereof, and shall furnish to LESSOR prints, on a scale of one inch equals one hundred feet, showing the results of said surveying, by accurate bearings and distances. LESSEE'S engineers shall consult with LESSOR'S engineers as to proper location of the outcropping of said Feds Creek (or Clintwood) seam, property lines and permanent points to be established.

TOGETHER WITH THE RIGHT to mine and remove the said coal in accordance with the mining rights vested in the LESSOR, it being distinctly understood and agreed that the LESSOR grants only such mining rights and privileges as it possesses or has acquired in conjunction with the ownership of the coal covered by this agreement; and that in mining, removing and carrying away said coal the LESSEE shall be limited to the exercise of the aforesaid rights and privileges, and shall protect and save harmless the LESSOR from any liability or any claims for damages to roads, railroads, wire or pipe lines, person, or

persons and/or property, except property owned by the LESSOR within the leased premises, caused by its operations hereunder. LESSOR agrees to so operate the seam hereby leased that overlying seams will not be injured or destroyed.

NOTHING HEREIN CONTAINED shall be deemed or construed to be a covenant on the part of the LESSOR, either expressed or implied, for title or for quiet enjoyment; but the LESSEE must respect and observe all limitations or defects in the title of the LESSOR in and to said land and the coal rights. It is likewise understood by the LESSEE that the LESSOR gives no warranty as the the quality or quantity of the coal contained in the leased premises and assumes no liability due to any deficiency which may exist or develop therein.

IN THE EVENT ANY PART of the said leased premises is lost to the holder of an outstanding superior title, if the LESSEE has mined and removed a part or all of the coal therefrom and paid the LESSOR therefor on the royalty basis, the LESSOR agrees to repay to the LESSEE the amount of royalty so paid, without interest, but the LESSOR shall not be otherwise liable for any damage on account of the mining and removing of said coal by the LESSEE, and the LESSEE shall protect and save harmless the LESSOR from all suits, actions damages or claims whatsoever, resulting or arising therefrom.

THE RIGHTS GRANTED THE LESSEE herein shall in all respects be inferior and subject to the rights granted by the LESSOR herein unto United Fuel Gas Company, by lease to Howe Oil and Gas Company, and passing by assignment to it, dated July 24, 1930, recorded in Deed Book 163, at page 84, Pike County Court Clerk's Office, which lease is referred to for more particular description of the rights therein granted and to which this lease is subject, but all rights and privileges respecting the mining of coal reserved in said lease to United Fuel Gas Company shall inure to the benefit of LESSEE, and, without limiting the generality of the foregoing, LESSEE shall

promptly transmit to LESSEE all information it has, or may receive, of prospective oil and gas drilling.

THE RIGHTS GRANTED THE LESSEE herein are also expressly made subject to the rights granted unto Stelco Coal Company by LESSOR by Agreement of Lease dated May 1, 1962, not recorded, granting the right to mine the Freeburn, or Lower Elkhorn, seam of coal overlying the area hereby leased, copy of said lease is furnished the LESSEE herein.

There is excepted and reserved from the area described herein the following tract:

Virginia Iron Coal and Coke Company Tract No. 468-A are as shown on above-mentioned whiteprint map on Orchard Hollow of Feds Creek, containing 0.32 ac., more or less.

IT IS UNDERSTOOD that the LESSEE shall not be required to mine coal where the thickness of the seam is under thirty-six (36) inches, including normal partings, but may do so; however, LESSEE must thoroughly prospect thin areas and if coal thirty-six (36) inches and over in thickness is found, LESSEE shall drive through or around thin areas and recover the thicker coal. If LESSEE mines coal from areas under thirty-six (36) inches, he must also remove coal pillars where he has mined the coal in the rooms.

THE LESSOR, ITS SUCCESSORS AND ASSIGNS, shall have the right at all times to mine, bore, search for, develop and market all other seams of coal in said land, and the oil, gas, minerals and other substances therein and thereon, and the right to use such of the leased premises as may be reasonably required for the purposes aforesaid, or any of them; also the right to lay in, on or under said land any and all pipe lines for conveying oil, gas, water or other substances from other tracts of land, as well as the right to construct telegraph, telephone and power lines, but such right shall be exercised in such a way as to interfere as little as possible with the mining operations of the LESSEE hereunder, all of which rights mentioned in

this paragrap are hereby expressly reserved to the LESSOR, its successors and assigns.

TO HAVE AND TO HOLD the hereinbefore described rights and privileges, excepting and reserving as aforesaid, unto the said LESSEE, during the term commencing on the first day of March, 1964, and terminating when LESSEE shall have exhausted all of The Feds Creek (or Clintwood) Seam of coal, subject to the exceptions herein set out, or until said tenancy shall be earlier terminated as thereinafter provided.

IN CONSIDERATION WHEREOF, THE LESSEE, FOR HIMSELF, HIS SUCCESSORS AND ASSIGNS, DOES HEREBY COVENANT, PROMISE AND AGREE TO AND WITH THE LESSOR, ITS SUCCESSORS AND ASSIGNS, AS FOLLOWS:

RENTAL

1st. The LESSEE shall pay to LESSOR, as rental, the Minimum sum of FIVE THOUSAND DOLLARS ($5,000) per year, payable monthly in advance, without regard to the quantity of coal mined, which sum shall be payable, without demand therefor, on or before the first (1st) day of each and every calendar month.

ROYALTIES

2nd. LESSEE shall pay unto LESSOR as tonnage royalty the sum of twenty-five cents (25¢) for each and every net ton of two thousand (2,000) pounds of coal mined from the leased premises, or lost or left in mining, in the manner following:

The royalty on all coal mined during each calendar month of the term hereof shall be paid on or before the 20th day of the succeeding month, and the LESSEE shall receive credit on every royalty payment due by the amount of the monthly installment of the annual rental paid for the month in which said tonnage was mined. If the amount of royalty which becomes due in any month of the term hereof does not exceed the rental paid for the month,

then the payment of said rental shall be a full and complete satisfaction of the said royalty. If the royalty aforesaid exceeds the rental paid for such month, then only such excess shall be paid in addition to the rental for that month; provided, however, that the LESSEE shall not be required to make any payments on account of any excess until all deficit, which might accrue under the provisions of ARTICLE 3rd hereof shall have been worked out.

CREDIT

3rd. The accounts of the LESSEE shall be so adjusted that if the quantity of coal which the LESSEE mines from the leased premises in any month of the term hereof is less than the quantity of coal required, calculated at the royalty rate provided herein, to produce a sum equal to the rental paid for such month, the LESSEE shall have the right to mine and remove in any future month or months of the term hereof, and without further royalty payment therefor, an amount of coal equal to such deficit in quantity, but only after sufficient tonnage, to pay the rental for the current month, shall have been mined.

It is always understood that whenever the total payments from all sources of either tonnage royalties or rentals, or for coal lost, shall amount to a sum of money which equals said tonnage royalty of twenty-five cents (25¢) on all of the coal now in the Feds Creek (or Clintwood) Seam in the leased premises which LESSEE is required to mine hereunder including all coal lost in mining and all coal remaining in pillars and supports, which may result from the LESSEE's mining operations, and also including coal in said seam under thirty-six inches in thickness which the LESSEE has actually mined and paid for, the LESSEE shall not thereafter be required to pay any further tonnage royalty or rental, but may continue to hold the leased premises without further payment of tonnage royalty or rental until the expiration of the term of this lease or sooner determination thereof. Howver, the burden shall be upon the LESSEE to develop and prove the total tonnage contained in said seam and the LESSEE shall never

have the right to recover from the LESSOR any payment of tonnage royalties or rentals on the ground that the total thereof is in excess of said tonnage royalty on all of the coal in said seam.

WEIGHTS

4th. The quantity of coal on which LESSEE pays royalty shall be determined by railroad weights of the railroad over which said coal is shipped, except such coal as may be otherwise disposed of, which shall be estimated by measurement of the bed of trucks on which same is delivered. A complete record and account of all coal mined by the LESSEE hereunder shall be kept at all times and shall be open to the inspection of LESSOR or its representatives. Coal delivered to the railroad and coal sold otherwise shall be reported separately.

TAXES

5th. LESSEE shall pay all taxes levied upon the entire estate of the LESSOR in the real estate covered hereby and upon all coal mined and produced therefrom, and also upon LESSEE's plant, equipment and improvements located upon the leased premises. If any payment of either of said taxes shall be made by LESSOR, the same shall be repaid by LESSEE upon statement and demand.

PLACE OF PAYMENT

6th. All rents, royalties or other moneys becoming due and payable by the LESSEE to the LESSOR under the terms hereof shall be paid promptly by the LESSEE unto the Treasurer of the LESSOR at its office, 600 two Penn Center Plaza, Philadelphia 2, Pennsylvania, at the times herein specified, without previous demand for the same, which manner and place of payment are hereby designated as the manner and place of all payments to be made by the LESSEE unto the LESSOR until such times as the LESSOR may, by written notice to the LESSEE, otherwise appoint or direct, and all payments shall be treated as rents reserved for the use of said premises.

NON-PAYMENT OF RENT—FORFEITURE

7th. In the event of the failure on the part of the LESSEE to make payment of rent, royalty and other moneys, or taxes, within the period of sixty (60) days next after the times herein fixed for such payments, the LESSOR may, at its option, terminate this agreement and declare the rights and privileges herein granted to be forfeited whereupon the said rights and privileges shall cease and determine, and this agreement shall become null and void and of no further effect, and the LESSOR may thereupon repossess itself of the premises, either by action of ejectment or by act of re-entry, using whatever force may be necessary, without any liability for damages for so doing.

RECORDS AND REPORTS

8th. LESSEE shall furnish unto LESSOR on or before the fifteenth (15th) day of each month a complete, correct and itemized settlement, in triplicate, on a form or forms furnished by LESSOR, showing for the preceding calendar month the number of tons of coal mined from the leased premises and any other information required by LESSOR. LESSEE shall keep and preserve full and complete records of all coal mined from the leased premises, which shall be open to the inspection of LESSOR at all times.

OPERATION

9th. LESSEE shall start operations within thirty (30) days from the date hereof, and shall conduct his operations in a careful and skillful manner and in accordance with any and all laws of the State of Kentucky, and of the United States of America, he shall not dump overburden, slate or mine refuse upon the mine property or adjoining land except at point or points to be designated in writing by the LESSOR.

LESSEE shall conduct his operations in a proper and skillful manner under the direction of a competent mining engineer and in compliance in every respect with the laws of the State of Kentucky and of the United States which

are now in force or which maybe hereafter enacted, and shall employ only the best and most improved methods of mining the coal to the end that the greatest possible amount of coal may be recovered. The mine shall be kept in good working order and condition, and no coal shall be left that might have been mined. The workings shall be left free from accumulation of water, and in such condition that the remaining coat may be recovered.

The operation of the Feds Creek (Clintwood) Seam of coal leased herein shall be conducted in such a manner as not to interfere with, injure or destroy the overlying Lower Elkhorn Seam of coal, now under lease to Stelco Coal Company. LESSEE agrees to locate and establish by proper engineering procedures, the outcrop of the said lower Elkhorn Seam of coal underlying the premises leased herein and to show the results of said location in relation to his workings in the Feds Creek Seam of coal leased herein, on his maps as hereinafter required.

LESSEE shall develop the Feds Creek Seam of coal leased herein underlying the aforementioned Lower Elkhorn Seam of coal now under lease to Stelco Coal Company in accordance with plans of mining and descriptions thereof which shall be prepared by LESSEE and submitted to LESSOR for his approval, and put in operation only upon approval in writing by said LESSOR. No change in any plan so approved shall be made in the development or operation of the said Feds Creek Seam of coal leased herein except as requested in writing by LESSEE and approved in writing by LESSOR, or as required in writing by LESSOR, such request or requirement to be accompanied by plans illustrating such change.

LESSEE shall give LESSOR prompt notice in writing of any coal which may be lost in mining under this lease, and should any coal be lost through negligent, careless or improper mining by LESSEE, LESSEE shall pay for the same as if mined and removed and at the times herein fixed for the payment of royalty on coal mined and removed; provided, however, that barrier pillars required by law and pillars left standing for the support of surface

improvements or for the support and protection of the overlying Lower Elkhorn Seam of coal, upon the requirement of LESSOR as above set forth, shall not be deemed lost coal.

SURVEYS AND MAPS

10th. LESSEE shall have a survey of the mine workings made by a competent mining engineer promptly as the work progresses, said survey to be based upon LESSOR's meridian and coordinate values on its base line from the mouth of Dicks Fork of Feds Creek, up said Fork of Feds Creek and up to Hylton Triangulation Station, said meridian and coordinate values to be furnished to LESSEE by LESSOR prior to the beginning of said survey, and LESSEE shall keep an accurate and complete map of the leased premises and mine workings, (on a scale of one hundred feet (100') to the inch, which map shall conform in all respect with the requirements of the bituminous mining laws of the State of Kentucky and the United States, as now in force or which may be hereafter enacted, and shall show all property lines, surface improvements and such natural topography as may require protection against liability for damages to persons or property, or by flooding in the operation hereunder. Such map shall at all times be accessible to the LESSOR, its agents or representatives, for inspection and a true, complete and correct copy of the same, posted to January 1, April 1, July 1, and October 1, of each year, shall be furnished in triplicate to the LESSOR, without demand, within ten days after the above-mentioned dates. All rooms and entries, except those following a water drainage course, shall be driven on transit survey sights, and no ribs or pillars shall be drawn until a survey of the place driven to its destination has been made. Accurate measurements at divers places of the thickness and elevation of the seam of coal, as the same is mined, the location of faults, clay veins, rolls and areas of bad roof shall be shown on the mine maps.

LESSEE shall furnish to LESSOR on or before the twentieth (20th) day of January of each year of the term

hereof, and as such other times as may be fixed by law or required for tax assessments, a statement showing the acreage of the herein leased seam of coal mined, abandoned, lost and remaining, separated as to tracts.

INSPECTION

11th. LESSOR, its agents, engineers or other persons in its behalf, with their assistants, shall have the right to enter at all times the said mines or works of LESSEE, in order to inspect, examine, select samples of coal, survey or measure the same or any part thereof, for the purpose of ascertaining the condition of the mine, the methods practiced, as well as the amount of coal removed, or for any other lawful purpose, and LESSOR shall have the right to place and keep an inspector or other representative upon the tipple and in the mine of LESSEE, for the purpose of checking the weights, measures, accounts and methods of LESSEE, and for these purposes to use freely the means of access to the said mines and works without let, hindrance, or molestation. LESSOR alone shall be responsible for any injury to any agents, engineers or other persons in its behalf who may enter said mines or works of LESSEE, unless such injury is caused by the negligence of LESSEE or his employees.

DAMAGES

12th. LESSEE shall so conduct his mining operations as not to violate any rights of lateral and subjacent support belonging to the owners of other estates, and shall assist the LESSOR in the defense of any action instituted for the recovery of any damages, resulting from his operations hereunder or prior to execution of this agreement, to the overlying strata or to the surface overlying the Feds Creek or Clintwood Seam of coal leased hereby, or to any buildings or other structures thereon erected, or to any springs, waterways or watercourses thereon or thereunder, or to any other estate so situated as to be in any manner affected. LESSEE shall notify LESSOR at once of any action instituted against LESSEE for the recovery of

damages aforesaid, so that a proper defense against such suit may be arranged for and agreed upon. LESSEE alone shall be responsible for any injury to any person or property, caused by the mining, handling or preparation of coal produced hereunder, and for any mining outside the leased premises, and shall save LESSOR harmless from all suits, actions, loss and/or damages resulting therefrom.

ASSIGNMENTS

13th. LESSEE shall not assign, or subject in whole or in part, this agreement or the estate created hereby or any interest therein, or part with the possession of said premises or any part thereof without first obtaining the consent in writing of LESSOR thereto, but nothing herein shall be construed to prevent LESSEE from subletting any part of the leased premises for tenements, minders' houses, stores, schools, churches or other facilities incidental to the mining of the leased coal or necessary to the providing of adequate mining community for the purposes hereof.

INSOLVENCY, BANKRUPTCY, ETC.

14th. LESSEE shall not permit this agreement or the estate hereby created or any interest therein to be levied upon or sold under any execution or other legal proceeding or process whatsoever. The assignment or transfer of this agreement or the estate and rights created or any of them under judicial process or under judgment or decree or adjudication of LESSEE as a bankrupt, or the discharge of LESSEE by any court as an insolvent debtor, or the assignment or subletting by him of any interest in this agreement, or the parting with the possession of the premises or any part thereof, without the written consent of LESSOR as above provided for, may, at the option of LESSOR, be considered and held as an absolute forfeiture of this agreement, and thereupon, all the rights of LESSEE hereunder shall at once cease and determine, and LESSOR, in addition to all of its other legal rights and remedies, may, at its option, at once resume possession of the premises and all the improvements hereinbefore men-

tioned, either by legal process or by summary proceedings without legal process.

CANCELLATION

15th. This agreement of lease may be cancelled by either party hereto at any time by either party giving to the other thirty (30) days written notice of its or his intention to cancel same. Said notices shall be sufficient if given by registered letter postmarked in the United States mails, and thirty (30) days after receipt of such letter said agreement of lease shall stand cancelled and terminated, and shall be of no further force and effect.

REMEDIES

All of the foregoing powers of reentry, and all other provisions for enforcement of the rights of LESSOR are remedies cumulative to one another and to all other remedies, suits, actions and proceedings at law or in equity, that LESSOR may choose to exercise and for the purpose of enforcing the payment of any rent or royalty the said LESSOR shall not only have all rights and remedies provided at any time by the laws of the State of Kentucky for landlords, but a lien is hereby created and imposed upon this lease and the leasehold estate hereby created with all the rights and privilegs conferred upon LESSEE hereunder, together with all the improvements placed by LESSEE upon the leased premises, to secure the payment of all rent, royalty or other moneys of every kind and character accruing or becoming due at any time under this lease.

MODIFICATION AND ALTERATION

17th. NO MODIFICATION, ALTERATION, WAIVER, OR ADDITION to this agreement or any part thereof shall be valid or binding or be set up or relied upon by either party unless the same be in writing and signed by LESSOR and LESSEE. No evidence of any such modification, alteration, waiver or addition shall be received in

any controversy arising out of this agreement, except it be in writing and signed as aforesaid.

WAIVER

18th. NEGLECT OR REFUSAL OF LESSOR at any time to avail itself of any of its rights or remedies hereunder shall not be construed as a waiver of its right and privilege to avail itself of each and every of such rights and remedies whenever and as often as any new ground therefor may arise.

CONDITIONS

19th. THE TERMS, PROVISIONS, COVENANTS AND STIPULATIONS herein contained shall be taken and deemed as conditions for the breach of which the term hereof may be forfeited.

IN TESTIMONY WHEREOF, LESSOR has caused its name to be signed and its seal to be affixed hereunto by its proper officers, thereunto duly authorized, and LESSEE has subscribed his name hereunto, this the day and date first hereinbefore written.

EXECUTED IN DUPLICATE

KENTLAND COAL AND COKE COMPANY
DIVISION OF THE BERWIND-WHITE COAL MINING COMPANY

ATTEST:

_____ By _____

Secretary President

_____

Eugene H. Bane

WITNESSES:

_____

_____

RELEVANT DOCKET ENTRIES

BULL RUN MINING CO., INC.,
A WEST VIRGINIA CORPORATION

v.

THE UNITED STATES

Jul 27 1977	Filing fee of $10 paid by plaintiff.
Aug 16 1977	Notice of reference to Trial Judge Roald A. Hogenson filed. Copy to parties. vacated 11/8/77
Sep 26 1977	Defendant's answer filed. Copies (5) to atty.
Sep 28 1977	Trial judge's standard pretrial order on liability filed. Copy to parties.
Nov 8 1977	Notice of reassignment of case to Trial Judge Judith Ann Yannello filed. Copy to parties.
Dec 7 1977	Defendant's motion for extension of time (to February 5, 1978) to comply with pretrial order filed. Copies (2) to atty. ALLOWED DEC 8 1977.
Feb 3 1978	Defendant's motion for extension of time (to April 6, 1978) to comply with pretrial order filed. Copies (2) to atty. ALLOWED FEB 6 1978.
Apr 6 1978	Defendant's motion for extension of time (to June 5, 1978) to comply with pretrial order filed. Copies (2) to atty. ALLOWED APR 7 1978 with no further extension to be granted except for extraordinary circumstances.
Jun 15 1978	Trial judge's order pursuant to Rule 114 filed. Copy to parties.
Sep 15 1978	Plaintiff's motion for summary judgment filed. Copies (5) to deft.
Sep 15 1978	Plaintiff's motion for waiver of attaching copy of depositions to dipositive motion for

summary judgment filed. Copies (2) to deft. ALLOWED SEP 29 1978.

Oct 16 1978 Defendant's motion for extension of time (to Nov. 14, 1978) to file its response to plaintiff's motion for summary judgment filed. Copies (2) to atty. ALLOWED November 1, 1978.

Nov 14 1978 Defendant's motion for extension of time (to Dec. 14, 1978) to file its response to plaintiff's motion for summary judgment filed. Copies (2) to atty. ALLOWED: DEC 7 1978, to the extent that defendant is granted an extension of time to Monday, December 11, 1978.

Nov 22 1978 Plaintiff's objections to defendant's motion for enlargement of time to file response to plaintiff's motion for summary judgment filed. Copies (2) to deft.

Dec 11 1978 Defendant's cross-motion for summary judgment and brief, etc., filed. Copies (5) to atty.

Jan 15 1979 Plaintiff's reply to defendant's cross-motion for summary judgment, etc., filed. Copies (5) to deft.

Feb 5 1979 Defendant's reply brief in support of its cross-motion for summary judgment and in opposition to plaintiff's motion for summary judgment filed. Copies (5) to atty.

May 15 1979 Defendant's motion for order directing consolidation [in this, 49–77 and 403–75], and establishing schedule for oral argument filed. Copy to attys. ALLOWED MAY 24 1979 SEE ENTRY THIS DATE.

May 21 1979 Plaintiff's motion in opposition to defendant's motion for establishing schedule for oral argument filed. [in this, 49–77, and 403–75]. Copies (2) to deft., and to atty in 49–77 and 403–75.

May 24 1979	Re: defendant's motion, filed May 15, 1979. ALLOWED as to consolidation with the three plaintiffs' attorneys to argue first and granted 45 minutes to be divided as they may agree on or 15 minutes each, with defendant to argue thereafter for 45 minutes and with the court to determine at the time of oral argument how much, if any time, is to be allowed to plaintiff for rebuttal.
Jun 4 1979	In this, 403–75 and 49–77. Case No. 400–77 argued and submitted on plaintiff's motion for summary judgment and defendant's cross-motion for summary judgment, Case Nos. 403–75 and 49–77 argued and submitted on the merits [before, Davis, Kashiwa and Bennett].
Jul 18 1979	See 403–75 for Court Opinion.
Aug 8 1979	Trial Judge's Order pursuant to Rule 111 filed. Copy to parties.
Nov 21 1979	Stipulation and entry of judgment filed by defendant. Copies (2) to atty.
Nov 28 1979	Trial Judge's memorandum report for judgment filed. Copy to parties.
Dec 7 1979	Court filed order entering judgment for plaintiff in the sum of $20,960.43., plus statutory interest.
Dec 7 1979	Certified transcript of judgment mailed to attorney of record.

In the United States Court of Claims

No. 400–77

BULL RUN MINING CO., INC.,
A WEST VIRGINIA CORPORATION,

v.

UNITED STATES OF AMERICA, DEFENDANT

PETITION

TO THE HONORABLE THE CHIEF JUDGE AND THE ASSOCIATE JUDGES OF THE COURT OF CLAIMS:

1. Plaintiff, Bull Run Mining Co., Inc., is a corporation chartered under the laws of the State of West Virginia, on or about the 7th day of September, 1965, with its principal office located at Masontown, West Virginia. Said corporation was authorized to issue 100 shares of common stock with the par value of $100.00. Ten (10) shares were issued and outstanding during the fiscal year ending September 30, 1974. The following is a list of the shareholders and the number of shares owned by each at that time:

Carlton L. McKenney, Sr.	8
Mary McKinney	1
Carlton L. McKinney, Jr.	1
Total	10

Said corporation filed its income tax return for the fiscal year ending September 30, 1974, with the Internal Revenue Service Center, 3131 Democrat Road, Memphis, Tennessee, 38110, and paid the tax shown thereon to be owing in the amount of $8,216.49.

2. This action is brought pursuant to Section 1346 and 1491 of the Judicial Code (28 U.S.C.A. Sections 1346 and 1491) against the United States of America, as Defendant.

3. During the fiscal year ending September 30, 1974, Plaintiff, Bull Run Mining Co., Inc., was engaged in the business of mining and producing coal. Said company op-

erated under written agreement of lease dated the 21st day of June, 1967, between Preston County Coal and Coke Corporation, a corporation, Lessor, and Bull Run Mining Co., Inc., a corporation, Lessee. A copy of said lease, identified as Exhibit A is attached hereto and by reference is made a part hereof.

4. Said written lease granted to Bull Run Mining Co., Inc., Lessee, the exclusive right to mine and remove maximum amount of coal consistent with modern mining methods and in accordance with all existing rules, regulations and laws affecting deep mining of coal now in effect or which may hereinafter be placed in effect by the State of West Virginia or the United States subject to the terms of said lease, under certain tracts of land situate in Valley District, Preston County, West Virginia, known as Tracts 125 D and 126 D, as originally designated upon maps of the Bethlehem Mines Corporation, as more specifically set forth in said lease.

5. In consideration thereof, the Lessee agreed to pay to the Lessor the sum of 25¢ per ton for all coal mined and removed from the premises and which payment would be made on or before the 25th day of each calendar month for all coal mined and removed during the preceding calendar month. The lease does not require that the mined coal be sold or delivered to the Lessor, but the Lessee is authorized to extract and dispose of the coal underlying the leased premises to whomever and at what prices it chooses, without any restrictions.

6. Bull Run Mining Co., Inc., from the date of the above mentioned lease, to September 30, 1974, had made a substantial investment in the opening of the mine, construction of buildings, acquisition of mining equipment, vehicles and supplies in the amount of $167,385.54.

7. Bull Run Mining Co., Inc., must look to the proceeds from its sale of the coal as the sole source of the revenue from which it could recover the rents and royalties it paid for the privilege of mining and its investment in the lease, including the machinery, equipment and supplies, purchased to mine the coal.

8. As a result of the lease agreement with Preston County Coal & Coke Corporation, a corporation, hereinabove referred to, and its substantial investment in the opening and operating of said mine, the said Bull Run Mining Co., Inc., a corporation, acquired an economic interest in the coal which it produced under said lease agreement and was entitled to percentage depletion under Sections 611 and 613 of the Internal Revenue Code of 1954.

9. No claim for percentage depletion on the coal extracted has been claimed or deducted by the Lessor. The sole claimant to said percentage depletion deduction was the Bull Run Mining Co., Inc., a corporation.

10. Upon examination, the Commissioner of Internal Revenue, erroneously disallowed the depletion deduction claimed by the Plaintiff, Bull Run Mining Co., Inc., resulting in the assessment of deficiencies in income tax against the said Bull Run Mining Co., Inc., a corporation.

11. On or about the 5th day of May, 1976, Plaintiff, Bull Run Mining Co., Inc., paid the deficiency resulting from the disallowance of the depletion for a fiscal year ending September 30, 1974, as provided by law, in the amount of $34,031.99. The interest and penalty notice in the amount of $3,137.62 was paid on or about the 22nd day of April, 1976.

12. On or about June 25, 1976, Plaintiff, Bull Run Mining Co., Inc., filed a 1120X, Claim for Refund, for the fiscal year ending September 30, 1974, with the Internal Revenue Service Center, 3131 Democrat Road, Memphis Tennessee, for the amount of $21,591.08, plus interest. A copy of said 1120X identified as Exhibit B is attached hereto and made a part hereof. This claim was based on the fact that Bull Run Mining Co., Inc., was entitled to $5,000.00 deduction for the rental of equipment that the agent erroneously disallowed in his report, and was entitled to the depletion claim in the amount of $39,981.41 which it was entitled to for the fiscal year ending September 30, 1974.

13. The Commissioner, on re-examination of the records of Bull Run Mining Co., Inc., and by his report dated February 16, 1977, allowed the $5,000.00 deduction for rent expense but refused to allow the deduction for depletion as claimed by the Bull Run Mining Co., Inc., in the amount of $39,981.41. A copy of said Commissioner's Report identified as Exhibit C is hereby attached and made a part hereof.

14. By reason of the Commissioner's failure to allow the claim for refund of the Plaintiff for the deduction for depletion as set forth above for the year ending September 30, 1974, plus interest, are now wrongfully withheld from the Plaintiff without its consent and against its will, in the amount of $18,257.40.

15. The amount claimed represents the additional income taxes paid by the Plaintiff to the Internal Revenue Service Center located at 3131 Democrat Road, Memphis, Tennessee, 38110, as a result of the disallowance of the claimed percentage depletion to the Bull Run Mining Co., Inc., for the fiscal year ending September 30, 1974.

16. No action has been had on said claim in the United States Congress, or any of the departments of government, or in any other judicial proceeding, including in the Tax Court of the United States; no other persons, firms or corporations, other than the Plaintiff, are the owners thereof or interested therein; no assignment or transfer of this claim or any part thereof, or interest therein, has been made; Plaintiff is justly entitled to the amount herein claimed from the United States after allowing all just credits and offsets. The Plaintiff has, at all times, born true faith in the allegence of the government of the United States and has not, in any way, voluntarily aided, abedded or given encouragement against the said government.

WHEREFORE, Plaintiff, Bull Run Mining Co., Inc., asks judgment against the United States of America in the sum of $18,257.40, together with costs and interest to the ex-

tent allowed by law, and for such other and further relief as may to this Honorable Court, seem just and proper.

BULL RUN MINING CO., INC.,
A WEST VIRGINIA CORPORATION, *Plaintiff*
By Counsel

WOODROW A. POTESTA,
Attorney at Law,
Suite 607 Deveny Building,
Fairmont, WV 26554.
Counsel for Plaintiff.

EXHIBIT A

THIS LEASE AND AGREEMENT, made this 21st day of June 1967, between PRESTON COUNTY COAL AND COKE CORP, a corporation, party of the first part, the LESSOR, and BULL RUN MINING COMPANY, a corporation, party of the second part, the LESSEE;

WITNESSETH: That for and in consideration of the sum of ONE DOLLAR ($1.00), cash in hand paid, receipt of which is hereby acknowledged, and of the further rents and royalties to be paid by the Lessee to the Lessor, and the further covenants and conditions to be kept and performed by Lessee, the said Lessor does hereby let and lease unto the said Lessee, all of the unmined coal of the Upper Freeport vein, situate on and under those certain tracts of land situate in Valley District, Preston County, West Virginia, known as Tracts 125D and 126D, and as originally designated upon maps of the Bethlehem Mines Corporation, and which tracts were conveyed to the Lessor herein by Shay-Boyle Land Company, a corporation, by deed dated April 1, 1950, and of record in the office of the Clerk of the County Court of Preston County, West Virginia, in Deed Book 278, page 217, excepting, however, a 10 acre reservation of said Tract 126D, said tracts and said reservation being shown on a map, a copy of which is in the possession of both parties hereto, all upon the following terms and conditions:

1. *MINING RIGHTS*. Lessee shall have and is hereby given the right to mine and remove coal from the tracts herein leased by the deep mining method, using all of the deep mining rights therewith as are owned by the Lessor, and which deep mining rights are hereby let and leased, together with said coal, and the right to use and exercise said deep mining rights as fully and completely as if the same were set out verbatim herein, but further provided that the Lessor leases no greater mining rights with said coal than it may own.

Lessee shall mine and remove said coal in a good workmanlike manner so as to mine and remove a maximum amount thereof consistent with modern mining methods and in accordance with all existing rules, regulations and laws affecting the deep mining of coal now in effect or which may hereinafter be placed in effect by the State of West Virginia or the United States.

2. *TERM*. The term of this lease shall be for a period of five (5) years from the date first hereinabove set forth or sooner if all of the coal is mined and removed from the demised premises which can be mined and removed by the use of modern mining methods. If all of said coal is not so removed at the end of the original term hereof, the Lessee may renew this lease for an additional term of five (5) years upon giving to Lessor written notice of its intention to renew, which notice shall be sent by mail to the Lessor at Cascade, West Virginia, prior to the expiration of the original term hereof.

3. *ROYALTY*. Lessee shall pay unto the said Lessor, the sum of TWENTY-FIVE CENTS ($.25) per ton for all coal mined and removed from the demised premises, and which payment shall be made on or before the 25th day of each calendar month for all coal mined and removed during the preceding calendar month, and shall be accompanied by a statement showing the total number of tons of coal mined. The books and records of Lessee, as well as inspection of the mine or mines, shall be reserved to the Lessor at all reasonable times in order to verify the accuracy of the weights of the coal mined and removed.

4. *LESSEE'S DUTIES.* Lessee, in addition to mining and removing the coal by modern mining methods, shall comply with all existing workmen's compensation laws, and shall operate siad coal as an independent lessee and in no other legal capacity as far as the Lessor is concerned, and shall save Lessor harmless of and from any and all liability arising out of or resulting from the mining of said coal, the transportation of same to market, and any other act or thing arising out of Lessee's operations. Lessee shall further carry and keep in effect, a public liability insurance policy in an amount of at least ONE HUNDRED THOUSAND DOLLARS ($100,000.00), to cover personal injuries or property damage.

5. *CANCELLATION.* It is agreed between the parties that either party to this agreement may cancel this lease upon giving to the other party a written notice at least thirty (30) days prior to the effective date of said cancellation. If any coal is mined during said thirty (30) day period, the same shall be paid for the same as if said notice were not given, and upon the expiration of said thirty (30) days, Lessee agrees to deliver the possession of said premises to the Lessor. Upon such cancellation becoming effective, Lessor shall reasonably compensate Lessee for the then fair market value of track, conveyors, dumps, bins, motors and other equipment which Lessee shall have affixed to the premises, and if the parties cannot agree upon such compensation, Lessee shall have a period of four (4) months within which to remove his equipment, from the effective date of cancellation.

6. *ASSIGNMENT.* This lease, nor any part hereof, nor any portion of the demised premises, may be assigned or sublet by the Lessee to any other person, firm, or corporation, without the express prior written consent of the Lessor.

7. *LANDLORD'S LIEN.* The Lessor herein reserves all of the rights reserved to a landlord under the laws of the State of West Virginia, for the payment of all of the rents and royalties to become due under the terms hereof, and any waiver of such rights by the Lessor shall not be con-

strued as a waiver of any subsequent breach or failure to make payments required hereunder on the party of the Lessee herein.

WITNESS the following signatures and seals:

PRESTON COUNTY COAL AND COKE CORP.,
A CORPORATION.

BY: _____ (SEAL)

ITS: _____

LESSOR.

BULL RUN MINING COMPANY,
A CORPORATION.

BY: _____ (SEAL)

ITS: _____

LESSEE.

STATE OF WEST VIRGINIA,
COUNTY OF PRESTON, TO-WIT:

I, HOWARD D. BURGE, a Notary Public in and for said County and State, hereby certify that PAUL S. LINSLEY, whose name is signed to the foregoing writing bearing date the 21st day of June, 1967, for Preston County Coal and Coke Corp., a corporation, has this day, before me, acknowledged the said writing to be the act and deed of said corporation.

Given under my hand this 6th day of July, 1967.

My Commission expires June 21, 1968.

/s/ _____
Notary Public

STATE OF WEST VIRGINIA,
COUNTY OF PRESTON, TO-WIT:

I, HOWARD D. BURGE, a Notary Public in and for said County and State, hereby certify that C. L. MCKINNEY,

whose name is signed to the foregoing writing bearing date the 21st day of June, 1967, for Bull Run Mining Company, a corporation, has this day, before me, acknowledged the said writing to be the act and deed of said corporation.

Given under my hand this 6th day of July, 1967.

My Commission expires June 21, 1968.

/s/ _____

Notary Public

THIS INSTRUMENT WAS PREPARED BY CHARLES V. WEHNER, ATTORNEY AT LAW, KINGWOOD, WEST VIRGINIA.

In the United States Court of Claims

No. 400–77

BULL RUN MINING CO., INC.,

Plaintiff

v.

THE UNITED STATES,

Defendant

ANSWER

Sep 26 1977

Defendant, the United States, in answer to the petition in the above-captioned case, respectfully denies each and every allegation therein not admitted, qualified, or expressly referred to below.

Defendant further:

1. Admits the allegations contained in paragraph 1.

2. Admits that proper jurisdiction, if it exists, is conferred upon this Court by 28 U.S.C. Section 1491.

3. Admits the allegations contained in paragraph 3.

4. Admits that said written lease recites that Bull Run Mining Co., Inc., lessee, was granted the right to mine and remove coal consistent with modern mining methods and in accordance with all existing rules, regulations, and laws affecting deep mining of coal now in effect or which may hereinafter be placed in effect by the State of West Virginia or the United States subject to the terms of said lease, under certain tracts of land situate in Valley District, Preston County, West Virginia, known as Tracts

125D and 126D, as originally designated upon map of the Bethlehem Mines Corporation, as more specifically set forth in the lease.

5. Admits the allegations contained in the first sentence of paragraph 5. Avers that its attorneys presently lack knowledge or information sufficient to form a belief as to the truth of the allegations contained in the last sentence of paragraph 5.

6–7. Avers that its attorneys presently lack knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 6 and 7.

8. Denies the allegations contained in paragraph 8.

9. Avers that its attorneys presently lack knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 9.

10. Admits that upon examination the Commissioner of the Internal Revenue Service disallowed the depletion deductions claimed by the plaintiff resulting in an assessment of deficiencies in income tax. Denies the allegations that the said disallowance was erroneous.

11–13. Admits the allegations contained in paragraphs 11 through 13.

14–15. Denies the allegations contained in paragraphs 14 and 15.

16. Avers that its attorneys presently lack knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 16.

WHEREFORE, defendant respectfully requests that the petition be dismissed, with all allowable costs assessed against plaintiff.

Respectfully submitted,

M. CARR FERGUSON
Assistant Attorney General

MARC LEVEY
Attorney

SEPTEMBER 26, 1977

EXHIBIT (D)

THIS DEED, made this 1st day of April, 1950, between Shay-Boyle Land Co., a corporation organized and existing under the laws of the State of West Virginia, party of the first part, the Grantor, and Preston County Coke Company, a corporation organized and existing under the laws of the same State, party of the second part, the Grantee;

WITNESSETH: That for and in consideration of the sum of ten dollars ($10) cash in hand paid and other good and valuable consideration, receipt of all of which is hereby acknowledged, the said Grantor hereby grants and conveys with covenants of General Warranty, unto the said Grantee, all of the hereinafter described tracts of coal, with the mining rights therewith, lying and being in Valley District, Preston County, West Virginia, being part of that certain acreage of coal and other real estate which was conveyed to the Grantor herein by John P. Boyle and wife and Paris R. Shay, Jr. and wife, by deed dated March 29, 1950, and to be recorded in the office of the Clerk of the County Court of Preston County, West Virginia; and further, part of those certain tracts of coal and real estate conveyed to the said John P. Boyle and Paris R. Shay, Jr. by Sunnyhill Coal Company, by deed dated February 4, 1950 and recorded in said county clerk's office in Deed Book 276, page 119; and further, part of those tracts conveyed to said Sunnyhill Coal Company by Sunnyhill Mining Company by two deeds, both of which are dated December 31, 1949 and recorded in said County Clerk's office in Deed Book 276, pages 100 and 104, it being the intention of Grantor to convey all coal it may own under the tracts hereinafter described, and which said tracts of coal and mining rights are designated on that certain Key Number Index now in possession of Grantor as Tracts 115-D, 116-D, 117-D, 118-D, 119-D, 120-D, 122-D, 123-D, 124-D, 125-D, 126-D and 191-D, and further shown on an Easter Colored Map now recorded in Deed Book 229, pages 10 and 11, and which said tracts of coal, and mining rights therewith, are further bounded and de-

scribed by metes and bounds and by deed book and page reference to certain predecessors in title to said Sunnyhill Mining Company, as follows:

FIRST: Beginning at a stone pile in old line, S. 49° E. 22.76 poles to a poplar stump; N. 32¾° E. 102.02 poles; N. 43½° E. 74.6 poles; N. 73° W. 100 poles to a chestnut, in MacPeck's line, with his line, S. 28¼° W. 140.64 poles to stake in center of road; S. 50¼° E. 49.16 poles to the beginning, containing 78.212 acres.

And together with said coal and appurtenant thereto the right and privilege of mining and removing all of said coal, together with the necessary and convenient rights of way through and under said land, with necessary drainage, ventilation and ventilating shafts to remove said coal upon and under said land, and also to remove thereunder the coal under other lands owned or that may be hereafter acquired by the Grantee, or his assignee, free from all liability on account of any damage that may arise or result from the removal of any or all of said coal, and without being liable for any damages that may result to the overlying strata or surface or anything therein or thereon, or any springs or water courses therein or thereon, by reason of the failure of said Grantee, to provide supports for said overlying strata or surface, or by reasons of the mining and removal of all of said coal under said land.

The coal and mining rights above described are the same as were conveyed by John B. Graham and others to Stephen B. Elkins, by deed dated November 6, 1902, and recorded in the office of the Clerk of the County Court of Preston County, West Virginia, in Deed Book 99, page 59.

SECOND: beginning at a beech and gum, corner G.W. Radabaugh and James M. Carroll, now H.D. Carroll, running with crop, S. 36° E. 39 poles; S. 58½° E. 72.9 poles to a stake in Robey's line, and with his line, N. 69½°E. 105.2 poles; S. 26½° E. 13.0 poles; S. 69½° W. 11.9 poles; S. 23° E. 29.5 poles to Reserve, and with same S. 85° E. 14.) poles; S. 23½° E. 13 poles to crop, with same S. 71° E. 48.4 poles to a B.O., corner to David Graham and with his lines, N. 67½° E. 118 poles to a large Gum; N. 84°E. 15.28

poles; N. 88¾° E. 16.48 poles; No. 68¾° E. 5.0 poles, N. 15° E. 5.0 poles; N. 10° E. 3.32 poles; N. 59¾° E. 5.8 poles; N. 27½° E. 3.64 poles; N. 8¼° E. 5.52 poles; N. 28¾° E. 14.0 poles; N. 21° E. 7.0 poles; N. 28° E. 4.0 poles; N. 57° E. 5.36 poles; N. 3¼° W. 11.80 poles; N. 10½° E. 11.2 poles; N. 15¾° E. 10.24 poles; N. 47¼° E. 7.2 poles; N. 38¾° E. 11.52 poles; N. 48¾° W. 44.24 poles; N. 50¾° W. 21.08 poles; S. 68¼° W. 53.0 poles to Reserve and with said line, S. 21¾° E. 8.0 poles; S. 68¼° W. 20.0 poles; N. 21¾° W. 8.0 poles back to D. Graham's line; S. 82¼° W. 2.24 poles; N. 59½° W. 2.56 poles; S. 86¼° W. 3.6 poles; S. 80¾° W. 4.24 poles; South 63¼° W. 4.92 poles; S. 83½° W. 5.08 poles; S. 13¼° W. 5.00 poles; S. 79½° W. 4.32 poles; S. 68¼° W. 1.0 poles; N. 21½° W. 22.72 poles; corner to B.V. McMillen's land, and with his line, N. 42½° W. 22.6 poles to McCauley heirs, and with four lines, S. 56½° W. 145.6 poles; N. 30¼° W. 19.6 poles; N. 88¾° E. 5.08 poles; N. 11° W. 48.52 poles to James M. Carroll, now D.H. Carroll, and with three of his lines, S. 53½° W. 22 poles; N. 30¾° W. 35 poles; S. 50¾° W. 127.7 poles to the beginning, containing 300.408 acres, more or less.

And together with said coal and appurtenant thereto the right and privilege of mining and removing all of said coal, together with the necessary and convenient rights of way through and under the land of said Grantors, with necessary drainage, ventilation and ventilating shafts to remove said coal upon and under said land, and also to remove thereunder the coal under other lands owned or that may be hereafter acquired by the Grantee, or his assignee, free from all liability on account of any damage that may arise or result from the removal of any or all of said coal, and without being liable for any damages that may result to the overlying strata or surface or anything therein or thereon, or any springs or water courses therein or thereon, by reason of the failure of the said Grantee to provide supports for said overlying strata or surface, or by reason of the mining and removal of all of said coal under said land; but shafts and openings for the purpose aforesaid are not to be located nearer than twenty rods of

the principal buildings existing on said land. Reserving only the right to bore through the coal hereby conveyed for oil and gas, provided such boring is done in such manner as to in no way interfere with the mining and marketing of said coal.

The coal and mining rights above described are the same as were conveyed by Amaziah D. Field and wife to Stephen D. Elkins, by deed dated November 7, 1902, recorded in said County Clerk's office in Deed Book 99, page 49.

THIRD: Beginning at a stake corner to A.D. Fields on coal crop, and with same, S. 89½° W. 100 poles; N. 29° W. 20.56 poles to A.D. Field's line, and with same N. 69½° E. 91.8 poles to school house, S. 37° E. 13 poles to A.D. Field's; S. 23° E. 42 poles to the beginning, containing 21.201 acres, more or less.

And together with said coal and appurtenant thereto the right and privilege of mining and removing all of said coal, together with the necessary and convenient rights of way through and under said land, with necessary drainage, ventilation and ventilating shafts to remove said coal upon and under said land, and also to remove thereunder the coal under other lands owned or that may be hereafter acquired by the Grantee, or his assignee, free from all liability on account of any damage that may arise or result from the removal of any or all of said coal or from the manufacture of the same into coke or other products and without being liable for any damage that may result to the overlying strata or surface or anything therein or thereon or any springs or water courses therein or thereon, by reason of the failure of the said Grantee to provide supports for said overlying strata or surface, or by reason of the mining and removal of all of said coal under said land.

The parties of the first part reserve the right to drill and operate through said coal for oil and gas, and other minerals, but such drilling and operation shall be done in such manner as not to injure in any way the property hereby conveyed nor interfere in any way with the rights and privileges herein granted to the party of the second part.

The coal and mining rights above described are the same as were conveyed by Louisa Robey and others to Stephen D. Elkins, by deed dated November 13, 1902, and recorded in Deed Book 99, page 143, in said County Clerk's office.

FOURTH: Beginning at a stone, corner to A.D. Field, and running S. 56½° W. 145.5 poles to a stone and pointers, near the County road; thence N. 30¼° W. 19.6 poles N. 88¾° E. 5.08 poles; thence N. 11° W. 48.5 poles to a stone in James M. Carroll's now H.D. Carroll's line; thence with the same, N. 53½° E. 110 poles to a stone pile; thence S. 42½° E. 68.7 poles to the beginning, containing 51.824 acres.

Also all the Upper Freeport vein of coal known locally as the seven foot vein, upon and underlying that certain tract of land, adjoining the aforesaid tract and bounded and described as follows:

Beginning at a sugar at Northwest corner of David Graham's, now J.H. Graham's land, and also corner to Brown and Graham, and with one of their lines, N. 68¼° W. 69 poles to a stake, corner to Keyser and Frankenberry and with two of their lines, S. 63¾° W. 117 poles; S. 27½° W. 13 poles to a white oak and stone pile, corner to H.D. Carroll; thence with two of his lines S.28½ W. 14.5 poles to a white oak and poplar and birch; S. 42½° E. 125.3 poles to a stone pile; N. 68¼° E. 84.4 poles; N. 9¼° E. 112.7 poles to the beginning, containing 121.645 acres.

Reserving, however, to the said Grantors the right to bore through said vein of coal for oil and gas, and to shaft for and mine any coal underlying the vein hereby conveyed, but such boring for oil and gas and such shafting and mining of said coal, shall be done in such manner as not to interfere in any particular with the Grantee in his deed, his heirs or assigns, in the exercise of the rights and privileges hereby conveyed to him.

And together with said coal and appurtenant thereto the right and privilege of mining and removing all of said coal, together with the necessary and convenient rights of way through and under said land with necessary drainage, ven-

tilation and ventilating shafts to remove said coal upon and under said land, and also to remove thereunder the coal under other lands owned or that may be hereafter acquired by the Grantee or his assignee, free from all liability on account of any damage that may arise or result from the removal of any or all of said coal or from the manufacture of the same into coke or other products, and without being liable for any damages that may result to the overlying strata or surface or anything therein or thereon, or any springs or water courses therein or thereon, by reason of the failure of the said Grantee to provide supports for said overlying strata or surface, or by reason of the mining and removal of all of said coal under said land.

The coal and mining rights above described are the same as were conveyed by Benjamin V. McMillen and wife to Stephen B. Elkins, by deed dated October 10, 1902, and recorded in said County Clerk's office in Deed Book 99, page 11.

FIFTH: Beginning at a white oak, poplar and birch N. 28½° E. 14.5 poles to a white oak and locust, also corner to Keyser & Frankenberry and B.V. McMillen, N. 27¾° W. 27 poles to a red oak, corner to Reserve, with three lines of same, S. 62¼° W. 13 poles; N. 27¾° W. 13 poles; N. 62¼° E. 13 poles N. 26° W. 92.5 poles; S. 51½° W. 109.3 poles to a stake in County road; S. 56° W. 32.7 poles; S. 3¼° W. 14 poles; S. 51⅓° W. 95.6 poles to a W.O. and beech; S. 16° E. 133.3 poles to a gum and beech, near County road; and corner to A.D. Field, with Field No. 50¾° E. 127.7 poles to a stake near County road; S. 30¾° E. 35 poles N. 53 ½° E. 137.4 poles N. 42½° W. 34 poles to the beginning, containing 233.754 acres, more or less.

And together with said coal and appurtenant thereto the right and privilege of mining and removing all of said coal, together with the necessary and convenient rights of way through and under said land, with necessary drainage, ventilation and ventilating shafts to remove said coal upon and under said land and also to remove thereunder the coal under other lands owned or that may be hereafter acquired by the Grantee of his assignee, free from all liabil-

ity on account of any damages that may arise or result from the removal of any or all of said coal and without being liable for any damages that may result to the overlying strata or surface or anything therein or thereon, or any springs or water courses therein or thereon, by reason of the failure of the said Grantee to provide supports for said overlying strata or surface, or by reason of the mining and removal of all of said coal under said land.

The coal and mining rights above described are the same as were conveyed by Hardin D. Carroll and wife to Stephen B. Elkins, by deed dated October 22, 1902, and recorded in said County Clerk's office in Deed Book 99, page 29.

SIXTH: Beginning at a beech and gum, corner to Ami D. Field's and James M. Carroll and running with Carroll's lines N. 16° W. 133.3 poles to W.O.; N. 51¼° E. 95.6 poles to a stake; N. 3¼° E. 14.0 poles to a stake; and leaving Carroll's line and running with John A. Radabaugh, N. 20° E. 5.4 poles; N. 1½° E. 4.8 poles; N. 12¾° W. 4.48 poles; N. 9° E. 4.0 poles; N. 34¾° W. 4.76 poles; N. 44¼° W. 3.6 poles; N. 88° W. 25.64 poles; S. 7° E. 5.48 poles; S. 32½° W. 7.0 poles; S. 43¾° W. 6.48 poles; N. 82½° W. 7.6 poles; S. 77½° W. 31.0 poles; N. 78° W. 25.6 poles to a hickory; N. 18° W. 45.36 poles to Parker's line and with same S. 67° W. 2.0 poles to John A. Radabaugh and with his line, S. 22½° W. 27 poles; S. 55½° E. 12 poles; S. 20¾° W. 28 poles; S. 50½° E. 12 poles; S. 17° W. 60.84 poles to a stake, beginning corner to John E. Radabaugh and with his line, S. 70½° E. 24.16 poles; S. 5¼° E. 12.0 poles; S. 8° E. 11.52 poles; S. 18° W. 7.32 poles to "Reserve" and with three of its lines, S. 66¾° E. 11.0 poles; S. 11¼° W. 4.0 poles; N. 84° W. 5.4 poles to crop and with same S. 21° W 16.0 poles; S. 42½° W. 30.0 poles; S. 19½° E. 18.0 poles; S. 24¾° E. 25.24 poles; S. 54¾° E. 19.0 poles; S. 79° E. 19 poles; N. 80½° E. 40.0 poles; N. 61¼° E. 6.4 poles to the beginning, containing 108.441 acres more or less.

And together with said coal and appurtenant thereto the right and privilege of mining and removing all of said coal, together with the necessary drainage, ventilation and ven-

tilating shafts to remove said coal upon and under said land, and also to remove thereunder the coal under other lands owned or that may be hereafter acquired by the Grantee of his assignee, free from all liability on account of any damage that may arise or result from the removal of any or all of said coal or from the manufacture of the same into coke or other products, and without being liable for any damages that may result to the overlying strata or surface or anything therein or thereon, or any springs or water courses therein or thereon, by reason of the failure of the said Grantee to provide supports for said overlying strata or surface, or by reason of the mining and removal of all of said coal under said land.

The coal and mining rights above described are the same as were conveyed by Damiel T. Gue and others to Stephen B. Elkins, by deed dated November 12, 1902, and recorded in said County Clerk's office in Deed Book 99, page 85.

SEVENTH: Beginning at stake, at end of Geo. W. Radabaugh's line, marked "N. 18° W. 45.36 poles" S. 88° E. 12.4 poles to stone pile; N. 13° W. 33 poles to crop, and with same N. 29½° E. 13 poles; N. 46° E. 15.2 poles to old road and corner to Lyons and with 11 of his lines, S. 77° E. 6 poles; N. 84½° E. 10 poles; S. 62¾° E. 36 poles; S. 79° E. 22 poles; S. 82½° E. 17.7 poles; S. 1¼° W. 9 poles S. 65½° E. 10.4 poles S. 80° E. 21.2 poles; S. ¼° W. 12 poles; S. 11½° E. 17 poles; S. 6° W. 18.4 poles to J.M. Carroll and with one of his lines S. 56° W. 32.6 poles to G.W. Radabaugh and with 14 of his lines N. 20° E. 5.4 poles; N. 1½° E. 4.8 poles; N. 12¾° W. 4.48 poles N. 9° E. 4 poles; N. 34¾° W. 4.76 poles; N. 44¼° W. 3.6 poles; N. 88° W. 25.64 poles; S. 7° E. 5.48 poles; S. 32½° W. 7 poles; S. 43¾° W. 6.4 poles; N. 82½° W. 7.6 poles; S. 77½° W. 31 poles; N. 78° W. 25.6 poles; N. 18° W. 45.3 poles to the beginning, containing 62.953 acres, more or less.

And together with said coal and appurtenant thereto the right and privileges of mining and removing all of said coal together with the necessary drainage, ventilation and ventilating shafts to remove said coal upon and under said

land and also to remove thereunder the coal under other lands owned or that may be hereafter acquired by the Grantee or his assignee, free from all liability on account of any damage that may arise or result from the removal of any or all of said coal or from the manufacture of the same into coke or other products, and without being liable for any damages that may result to the overlying strata or surface, or anything therein or thereon or any springs or water courses therein or thereon, by reason of the failure of the said Grantee to provide supports for said overlying strata or surface, or by reason of the mining and removal of all of said coal under said lands.

The parties of the first part reserve the right to drill and operate through the said vein of coal for oil and gas and other coal and minerals, but such drilling and operations shall be done in such a manner as not to injure, in any way, the property hereby conveyed nor interfere in any way with the rights and privileges herein granted to the party of the second part.

The coal and mining rights above described are the same as were conveyed by John A. Radabaugh and others to Stephen B. Elkins, by deed dated November 13, 1902, and recorded in said County Clerk's Office in Deed Book 99, page 149.

EIGHTH: Beginning at the end of George W. Radabaugh's line and running S. 17° W. 60.48 poles in John A. Radabaugh's line and with same S. 17° W. 57 poles to crop and with same, S. 77½° E. 8 poles; N. 73¾° E. 9 poles; N. 64½° E. 24 poles; N. 17° E. 5.04 poles, crossing out crop to George W. Radabaugh's reserve corner; N. 18° E. 7.32 poles; N. 8° W. 11.52 poles; N. 5¼° W. 12 poles; N. 70½° W. 24.16 poles to the beginning, containing 9.383 acres, more or less.

And together with said coal and appurtenant thereto the right and privilege of mining and removing all of said coal, together with the necessary and convenient rights of way through and under said land, with necessary drainage, ventilation and ventilating shafts to remove said coal upon and under said land, and also to remove thereunder the

coal under other lands owned or that may be hereafter aquired by the Grantee or his assignee, free from all liability on account of any damage that may arise or result from the removal of any or all of said coal or from the manufacture of the same into coke or other products, and without being liable for any damages that may result to the overlying strata or surface or anything therein or thereon, or any springs or water courses therein or thereon, by reason of the failure of the said Grantee to provide supports for any overlying strata or surface, or by reason of the mining and removal of all of said coal under said land.

The coal and mining rights above described are the same as were conveyed by John E. Radabaugh and wife to Stephen B. Elkins by deed dated November 12, 1902, recorded in said County Clerk's office in Deed Book 99, page 80.

NINTH: Beginning at a white oak by the County road leading from Herring to Bull Run; thence N. 4½° E. 20 poles; N. 7½° W. 18 poles; N. 2° E. 9.8 poles to a stake near end of a stone fence; thence leaving road, N. 79° W. 21.6 poles to a sugar stump; N. 62° W. 10.7 poles to a stone; N. 4° E. 8 poles to County road; thence with same N. 82° W. 12 poles; N. 76° W. 30 poles; N. 60½° W. 30 poles; N. 84° W. 10 poles; N. 88° W. 18 poles; N. 85° W. 14 poles to a stone pile in an original line; thence with same with the lines of A.K. Jenkins, N. 11½° W. 65 poles to a stake at crop of Freeport coal; thence with same N. 83° E. 20 poles to a stone, corner of coal reserve of one and one-half acres; thence three lines of same N. 70° E. 20 poles; N. 20° E. 12 poles; N. 70° W. 20 poles to a stone by hickory; thence still with coal crop, N. 5° W. 14 poles; N. 15¼° E. 14 poles; N. 37° E. 20 poles; N. 38½° E. 17.2 poles to an original line; thence with same N. 77½° E. 12 poles; thence still with coal crop, N. 72° E. 18 poles; N. 77° E. 28 poles; S. 43½° W. 12 poles; N. 87¼° E. 15 poles; N. 67½° E. 17.1 poles to stake in out line; thence with same S. 26° E. 22.7 poles to a stone pile; S. 64½° W. 49.6 poles to a fallen walnut; S. 58° E. 40.6 poles to a stone pile; N. 75¼° E. 26.8

poles to a white oak stump; S. 24° E. 44.8 poles to a stake; leaving original line and following coal crop, S. 9° W. 34 poles; S. 10¾° E. 49 poles; S. 78½° E. 10 poles; S. 52° E. 14.5 poles to a stake in H.D. Carroll's line; thence with same S. 52° 52′ W. 81.8 poles to the beginning, containing 175.9 acres.

There is further conveyed herein all coal and mining privileges with the right to enter upon and under said land and to mine and remove all of said coal, and to remove upon and under said land the coal from under other lands, together with all necessary and convenient rights of way through and under said land with necessary drainage, ventilation and ventilating shafts to remove said coal upon or under said land, and also to remove the coal under neighboring lands without damage arising from the mining and removal of said coal that may arise to the surface thereof.

The coal and mining rights above described are the same as were conveyed by Samuel P. Lyons and others to Elkins Coal & Coke Company, by deed dated July 20, 1906, and recorded in said County Clerk's office in Deed Book 114, page 22.

TENTH: Beginning at a walnut corner to Lyons and with three of his lines, S.59¼° E. 40.6 poles to stone pile; N. 73¼° E. 26.3 poles to stump; S. 25° E. 38.4 poles to poplar; N. 55½° E. 14 poles to crop and with same, N. 3½° E. 36 poles; N. 46½° E. 42 poles; N. 49¼° E. 56 poles to Pheobe Spurgeon; S. 71¼° W. 5.4 poles; S. 83½° W. 6 poles; S. 38° W. poles; S. 79¾° W. 8 poles; S. 76¾° W. 15.6 poles; N. 80° W. 4.7 poles; N. 62¼° W. 21.6 poles; N. 88¾° W. 15.4 poles; S. 68½° W. 54.7 poles to corner of Lyons and with his lines S. 22° 6′ E. 25.4 poles; S. 68° 8′ W. 49.2 poles to the beginning, containing 42.359 acres.

And together with said coal and appurtenant thereto the right and privilege of mining and removing all of said coal, together with the necessary convenient rights of way through and under said lands, with necessary drainage, ventilation and ventilating shafts to remove said coal upon and under said land, and also to remove thereunder and

thereover the coal under other lands owned or that may be hereafter acquired by the Grantee or his assignee, free from all liability on account of any damage that may arise or result from the removal of any of all of said coal, or from the manufacture of the same into coke or other products, and without being liable for any damages that may result to the overlying strata or surface or anything therein or thereon, or any springs or water courses therein or thereon, by reason of the failure of the said Grantee to provide supports for said overlying strata or surface, or by reason of the mining and removal of all of said coal hereby conveyed.

The coal and mining rights above described are the same as were conveyed by John W. Radabaugh and wife to Stephen B. Elkins, by deed dated December 18, 1902, and recorded in said County Clerk's office in Deed Book 99, page 192.

ELEVENTH: Beginning at a stump, corner to J.W. Radabaugh and Lyon and crop, and with same N. 38½° E. 26 poles; N. 7¾° W. 6 poles N. 36½° W. 21 poles N. 18° W. 10 poles N. 9½° E. 20 poles N. 63° E. 41 poles N. 7° E. 20.8 poles to reserve and with three lines of same S. 62¼° E. 16 poles N. 27¾° E. 10 poles N. 62¼° W. 16 poles N. ¼° W. 18 poles; N. 20¾° E. 91 poles S. 40½° E. 8 poles S. 19° E. 28 poles S. 2¼° E. 34 poles S. 11½° E. 57.4 poles S. 21¾° E. 72 poles to stake, corner to J.W. Radabaugh and with nine of his lines, crossing crop, S. 71¼° W. 5.4 poles S. 83½° W. 6 poles S. 38° W. 4 poles S. 79¾° W. 8 poles S. 76¾° W. 15.6 poles N. 80° W. 4.7 poles N. 62¼° W. 21.6 poles N. 88¾° W. 15.4 poles S. 68½° W. 54.7 poles to the beginning, containing 82.205 acres.

And together with said coal and appurtenant thereto the right and privilege of miiing and removing all of said coal, together with the necessary and convenient rights of way through and under all of said land, with necessary drainage, ventilation and ventilating shafts to remove said coal upon and under said land, and also to remove thereunder or thereon the coal under other lands owned or that may be hereafter acquired by the grantee or his assignee, free

from all liability on account of any damage that may arise or result from the removal of any or all of said coal or from the manufacture of the same into coke or other products and without being liable for any damages that may result to the overlying strata or surface or anything therein or thereon or any springs or water courses therein or thereon by reason of the failure of the said grantee to provide supports for said overlying strata or surface or by reason of the mining and removal of all of said coal hereby conveyed.

But there is reserved and excepted from this conveyance by the grantors, sufficient of said coal for farm and domestic use, and the right to bore or drill for oil, gas, or water, but such use of said coal and drilling for oil, gas and water shall be done in such a manner as not to interfere in any way with the mining rights and privileges hereinabove set out.

The coal and mining rights above described are the same as were conveyed by Philip M. Spurgeon and others, by deed dated January 16, 1903, and recorded in said County Clerk's office in Deed Book 99, page 284.

TWELFTH: Beginning at a Double Hickory, corner to A.D. Field; thence N. 49° 16′ W. 730.58 feet to a stake; thence N. 50° 58′ W. 343.27 feet to a Gum; thence S. 67° 35′ W. 1,204.76 feet to a stake near the mouth of a coal bank; thence S. 81° 15′ W. 36.7 feet to the head of coal bank drain; thence down the same with its meanderings, N. 61° 39′ W. 42.56 feet; thence N. 76° 44′ W. 60.41 feet; thence S. 84° 10′ W. 69.1 feet; thence N. 64° 47′ W. 80.79 feet; thence S. 81° 14′ W. 92.93 feet; thence S. 11° 22′ W. 85.45 feet; thence S. 83° 43′ W. 71.05 feet; thence S. 68° 20′ W. 16.23 feet to Bank's line; thence with the same N. 21° 53′ W. 363.89 feet to B.V. McMillen's line; thence with the same N. 67° 20′ E. 1,382.29 feet to a White Oak; thence N. 8° 20′ E. 1,894.57 feet to a Sugar Tree on Cheat Hill; thence S. 88° 05′ E. 2,505.56 feet to a Chestnut; thence S. 26° 48′ W. 2,226.12 feet to a Stake near an old Road; thence with the road S. 24° W. 332.01 feet to a stake; thence S. 26° 56′ W. 255.09 feet to a stake; thence S. 31° 13′ W. 195.02 feet to a stake; thence S. 22° 54′ W.

132.52 feet to a stake and pointers; thence S. 27° 48′ W. 98.05 feet to the old line at the bars; thence with the same N. 49° 15′ W. 87.8 feet to the beginning, containing 132.746 acres.

But there is reserved from the above boundaries a parcel containing one acre of the coal underlying it, bounded and described as follows:

Beginning at a stake near the coal bank where now opened and in use said tract, and the end of the third line of the above described calls; thence N. 18° 52′ W. 168.5 feet to a stake; thence N. 67° 35′ E. 265.32 feet to a stake; thence S. 18° 52′ E. 168.5 feet in said Third line of the above description; thence along said line S. 67° 35′ W. 265.32 feet of the beginning.

There is herein granted and conveyed to the said Grantee and assigns the right of way over and through said land free from any claim for damages to the surface by reason of the mining and removing of said coal thereby conveyed, together with the right to sink shafts and any buildings thereon that it or its assigns may desire in removing and manufacturing said coal thereon, also free from any liability therefor, as well the right to carry through, under said land coal from other lands that the said party of the second part, or its assigns may desire to.

The coal and mining rights above described are the same as were conveyed by David Earl Field and others to Elkins Coal and Coke Company by deed dated April 15, 1910, and recorded in said County Clerk's office in Deed Book 127, page 10.

There is further conveyed by the Grantor to the Grantee herein, all of the Grantor's right, title and interest in and to any surface which the Grantor may own overlying the parcels of coal hereinabove described, but reserving, however, in fee, to the Grantor, all of the roads and rights of way for roads, and all privileges incidental thereto, which Grantor now owns and possesses which may pass on, over or near said coal, and on, over, near and through any surface lands overlying said coal, provided, however that the Grantee is given the privilege of using said roads in con-

nection with the mining and removing said coal herein described and conveyed, for the length of time required for the mining and removing thereof.

Grantor further grants and conveys unto Grantee, for the consideration hereinabove set forth, the right to use an opening into and through the coal situate under Tract 121-D, being a tract of 100.264 acres of coal not herein conveyed, and to have pillars left therein for support so as to cause the Grantee to use said opening as headings for the purpose of gaining access to the coal adjoining said Tract 121-D, and the further right to extend said headings for the purpose of mining and removing the coal hereby conveyed; provided, however, that Grantee's use of said opening and headings is not to begin until Grantor's use thereof has been completed for the coal mining operations which it is now exercising under said Tract 121-D.

Witness the following signature and seal:

SHAY—BOYLE LAND CO.
BY: _____
ITS _____

STATE OF WEST VIRGINIA,
COUNTY OF PRESTON, TO-WIT:

I, CHARLES WEBNER, a notary public in and for said county and state, hereby certify that PARIS B. SHAY, JR., whose name is signed to the writing above bearing date the 1st day of April, 1950, for Shay-Boyle Land Co., a corporation, has this day, before me, acknowledged the said writing to be the act and deed of said corporation.

Given under my hand and official seal this 1 day of April, 1950.

My commission expires June 11, 1956.

_____
Notary Public

STATE OF WEST VIRGINIA, County of Preston, TO WIT:

I, P. F. KING, Clerk of the County Court of said County, do hereby certify that the foregoing writing was this day produced to me in my said office, and together with the certificate and Rev. Stamp thereto annexed, was duly admitted to record therein.

Given under my hand this 21 day of April, 1950—11:29 A.M.

A TRUE COPY

/s/ _____ Clerk

In the Supreme Court of the United States

No. 79-1515

UNITED STATES, PETITIONER,

v.

ELWOOD SWANK, ET AL.

ORDER ALLOWING CERTIORARI, FILED May 12, 1980

The petition herein for a writ of certiorari to the United States Court of Claims is granted.

☆U.S. GOVERNMENT PRINTING OFFICE 1980 321529 4

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1979

No. 79-1515

UNITED STATES OF AMERICA,
Petitioner,
v.
ELWOOD SWANK AND RITA SWANK

UNITED STATES OF AMERICA,
Petitioner,
v.
BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA,
Petitioner,
v.
BULL RUN MINING CO., INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF IN OPPOSITION

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Revenue Act of 1951, P.L. 183, 65 Stat. 452, 501-2, Section 325 20

Treasury Regulations on Income Tax (26 C.F.R.):
Section 1.272-1 . . . . . 4, 3a
Section 1.611-1(a)(1) 2
Section 1.611-1(b)(1) 2, 17, 18
Section 1.611-1(b)(2) 4, 17, 18, 21
Section 1.611-1(c)(2) 5, 18
Section 1.612-1 . . . . . 5, 7a
Section 1.613-1 . . . . . 5, 8a
Section 1.631-3 . . . . . 5, 9a

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Miscellaneous:

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1979

No. 79-1515

UNITED STATES OF AMERICA,

Petitioner,

v.

ELWOOD SWANK AND RITA SWANK

UNITED STATES OF AMERICA,

Petitioner,

v.

BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA,

Petitioner,

v.

BULL RUN MINING CO., INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims is reported at 602 F.2d 348, and is correctly reproduced in Appendix A, pages 1a-10a, of the Petition for a Writ of Certiorari. The opinion of the trial judge (*id.*, pages 10a-16a) and his

findings of fact, which are not printed with the court's opinion, apply only to Elwood Swank and Rita Swank (No. 403-75) (*id.*, page 9a). The Court of Claims adopted the parties' stipulation of facts as the court's findings of fact in Black Hawk Coal Corporation, Inc. (No. 49-77) (*id.*, page 4a, n. 2). In Bull Run Mining Co., Inc. (No. 400-77) the court found that the relevant facts were not in dispute and stated that its opinion reflected such facts as were necessary to sustain its disposition of the cross-motions for summary judgment (*ibid.*).

JURISDICTION

Respondents accept the statement of jurisdiction offered by Petitioner.

QUESTION PRESENTED

Whether the inclusion of a 30-day termination clause in a coal lease precludes the lessee's entitlement to the percentage depletion deduction prescribed by Section 611(a) and (b) of the Internal Revenue Code of 1954. (Black Hawk Coal Corporation case (No. 49-77), Stipulation of Facts, ¶ 15.) The Government admits that in the absence of this 30-day termination provision, the lessees would all be entitled to such depletion allowance.

STATUTES AND REGULATIONS INVOLVED

Petitioner cites and sets forth in Appendix C certain portions of Sections 611 and 613 of the Internal Revenue Code of 1954 (26 U.S.C.), and of Treasury Regulations on Income Tax, Section 1.611-1 (26 C.F.R.) (Petition for a Writ of Certiorari, pages 2, 23a-25a). Respondents agree that these provisions are involved.

In addition to the above provisions, Respondents respectfully invite the attention of the Court to the fol-

lowing pertinent provisions of the Internal Revenue Code of 1954 and Treasury Regulations issued thereunder:

Internal Revenue Code of 1954

Section 272. Disposal of Coal or Domestic Iron Ore.

Where the disposal of coal or iron ore is covered by section 631, no deduction shall be allowed for expenditures attributable to the making and administering of the contract under which such disposition occurs and to the preservation of the economic interest retained under such contract, except that if in any taxable year such expenditures plus the adjusted depletion basis of the coal or iron ore disposed of in such taxable year exceed the amount realized under such contract, such excess, to the extent not availed of as a reduction of gain under section 1231, shall be a loss deductible under section 165(a). This section shall not apply to any taxable year during which there is no income under the contract.

Section 611(b)(1). Allowance of Deduction for Depletion.

Special Rules – Leases.

(b) Special Rules. –

(1) Leases. – In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee.

Section 612. Basis for Cost Depletion.

Except as otherwise provided in this subchapter, the basis on which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain upon the sale or other disposition of such property.

Section 613(b)(4). Percentage Depletion Rates – Coal, etc.

(b) *Percentage Depletion Rates.* – The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

* * * * *

(4) *10 Percent-Asbestos* (if paragraph (1)(B) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite.

Section 613(c). Percentage Depletion. Definition of Gross Income from Property.

(For text, see Appendix A, *infra,* page 1a.)

Section 631(c). Disposal of Coal or Domestic Iron Ore With a Retained Economic Interest.

(For text, see Appendix A, page 2a.)

Treasury Regulations

Section 1.272-1. Expenditures relating to disposal of coal or domestic iron ore.

(For text, see Appendix A, page 3a.)

Section 1.611-1. Allowance of deduction for depletion.

(b) *Economic interest.*

* * * * *

(2) No depletion deduction shall be allowed the owner with respect to any timber, coal or domestic iron ore that such owner has disposed of under any form of contract by virtue of which he retains an economic inter-

est in such timber, coal, or iron ore, if such disposal is considered a sale of timber, coal, or domestic iron ore under section 631(b) or (c).

(c) *Special rules* –

* * * * *

(2) *Leases.* In the case of a lease, the deduction for depletion under section 611 shall be equitably apportioned between the lessor and lessee. In the case of a lease or other contract providing for the sharing of economic interest in a mineral deposit or standing timber, such deduction shall be computed by each taxpayer by reference to the adjusted basis of his property determined in accordance with sections 611 and 612, or computed in accordance with section 613, if applicable, and the regulations thereunder.

Section 1.612-1. Basis for allowance of cost depletion.

(For text, see Appendix A, page 7a.)

Section 1.613.1. Percentage depletion; general rule.

(For text, see Appendix A, page 8a.)

Section 1.631-3. Gain or loss upon the disposal of coal or domestic iron ore with a retained economic interest.

(For text, see Appendix A, page 9a.)

STATEMENT OF THE CASE

a. *Swank.* The termination clauses in the leases involved in this case were never exercised.

Pursuant to a deep mining lease dated October 24, 1964, Swank[1] as lessee deep mined anthracite coal from

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[1] References to Swank are to Respondent Elwood Swank. Rita Swank is a party solely because she filed joint federal income tax returns with her husband during the years in suit.

1964 through 1967. Pursuant to a stripping lease dated July 25, 1966, Swank as lessee strip mined anthracite coal during 1966 and 1967. The lessor under these mining leases was Northumberland County. The lessor never terminated the leases. Swank's successor, Split Vein Coal Company, Inc.,[2] is still mining pursuant to the stripping lease. The 1964 deep mining lease was abandoned in May 1968 because of a mountain slide caused by heavy rains which closed the deep mine, thereby preventing further mining of the mine by anyone. Swank and his successor, Split Vein Coal Company, Inc., deep mined coal under the deep mining lease until the mountain slide closed the mine. (Findings Nos. 6-9.)

Swank did not negotiate or prepare the leases. He could not do so. These leases were on standard forms prepared and used by the County of Northumberland. The leases were not subject to negotiation. Northumberland County never sold a fee simple interest in coal lands for fear of criticism over selling such land if valuable minerals were discovered subsequent to sale. The Northumberland County Commissioners told Swank that Northumberland County would not terminate his leases except for cause. The commissioners also announced this policy not to terminate mining leases except for cause in public meetings and in the press. Every lessee of county coal lands received the same form lease from the county and in each case it was with the stipulation that the county would not terminate except for cause. The

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[2]During 1966 and the first four months of 1967, Swank was a sole proprietorship. On May 1, 1967, the assets of the sole proprietorship were transferred to Split Vein Coal Company, Inc., in a tax-free incorporation pursuant to Section 351 of the Internal Revenue Code of 1954, as amended.

reason for this policy was that the county commissioners recognized that they could not expect a lessee of county coal lands, like Swank, to invest time and considerable capital in the development of county coal lands without some assurance that, if he conformed to the terms of the lease, he would be allowed to recover his investment and make a profit on his mine. (Findings Nos. 12, 12n.1, 15(a), 15(c).)

The Northumberland County Commissioners terminated mining leases only for cause, which meant:

(1) Failure to pay the royalties; or

(2) Failure to pay the correct amount of royalties; or

(3) Failure to make the mine productive. (Finding No. 15(a).)

The *Swank* leases contain no express language permitting Northumberland County to terminate the leases "without cause." The words "without cause" are not in in the leases. (Partial Stip. Exs. A, B, C.)

Swank was under no obligation to sell the coal to Northumberland County or any other party or person. He sold the coal to whomever he pleased at whatever price he could obtain. Swank sold no coal to Northumberland County.

The income which Swank received from his mining operations was solely derived from, and tied to, his extraction and sale of coal during the tax years involved. Swank looked solely to the extraction of coal for a return of his investment. (Findings Nos. 7, 10, 11, 14, 15.) Swank was not a mining contractor. He was mining coal as a lessee under valid coal leases. (Findings Nos. 6, 17.)

b. *Black Hawk Coal Corporation, Inc.* Respondents accept Petitioner's Statement with respect to Black Hawk (Petition for a Writ of Certiorari, pages 4-5) with the following exceptions and additions:

The termination clause in the lease was never exercised (Stipulation of Facts, ¶ ¶ 2, 3, 4, 5, and 7).

The Agreement of Lease at issue (Ex. 4 to Stipulation, ¶ 3) contains no provision that the lease may be cancelled "without cause." The provision relating to cancellation of the lease by either party is contained in paragraph 15th of the lease, and provides in full as follows:

> 15th. This agreement of lease may be cancelled by either party hereto at any time by either party giving to the other thirty (30) days written notice of its or his intention to cancel same. Said notices shall be sufficient if given by registered letter postmarked in the United States mails, and thirty (30) days after receipt of said letter said agreement of lease shall stand cancelled and terminated, and shall be of no further force and effect.

The fourth paragraph of page 3 of the lease provides as follows:

> TO HAVE AND TO HOLD the hereinbefore described rights and privileges, excepting and reserving as aforesaid, unto the said LESSEE, during the term commencing on the first day of March, 1964, and terminating when the LESSEE shall have exhausted all of the Feds Creek (or Clintwood) Seam of coal, subject to the exceptions herein set out, or until said tenancy shall be earlier terminated as hereinafter provided.

The lessee was required to pay minimum royalties (called "rental") of $5,000 per year in advance each month,

without regard to the quantity of coal mined, and tonnage royalties of 25 cents per ton, with provisions for the recoupment of minimum royalties by crediting them toward amounts due on tonnage royalties, and carryovers of this recoupment privilege to any future month in which coal was mined (Lease, ¶¶ 1st, 2d and 3rd). The lessee was required to pay all real estate taxes, all taxes on coal mined and produced, and all taxes on lessee's plant, equipment, and improvements (Lease, ¶ 5th).

Paragraph 9th of the lease provides that the lessee "shall start operations within thirty (30) days from the date [of the lease], and shall conduct his operations in a careful and skillful manner and in accordance with any and all laws of the State of Kentucky, and of the United States of America."

Black Hawk mined coal continuously from the leased property, starting in 1964, continuing through the taxable years involved herein (1970, 1971, and 1972), and ceasing in 1976, when all the coal feasible to mine had been extracted (Stipulation of Facts, ¶¶ 2, 3, 4, 5 and 7).

The actual mining of the coal was done by independent contractors employed by Black Hawk for this purpose. Under their oral agreement with Black Hawk, the mining contractors provided the labor and supervision necessary to mine the coal and to transport the mined coal to the tipple site, for a fixed dollar amount per ton – the price per ton paid to the contractors not being dependent upon the sales price of the coal. The contractors furnished the trucks used to haul the coal from the mine site to the tipple. Black Hawk furnished the majority of the mining equipment needed by the contractors to extract the coal, constructed and maintained the ac-

cess road, and built the power lines to the mining operation. (Stipulation of Facts, ¶ 5.)

Black Hawk sold none of its coal to the lessor or the latter's sales agency. (Stipulation of Facts, ¶ 7.)

No claim for percentage depletion has been made by the lessor under the lease with Black Hawk, and no claim for percentage depletion on the coal extracted has been made by the independent mining contractors. The sole claimant to the percentage depletion deduction is Black Hawk. (Stipulation of Facts, ¶ 9.)

c. *Bull Run Mining Co., Inc.* Because Petitioner's statement of the case omits some relevant facts, Bull Run's statement necessarily will be longer than would normally be required. The following facts are drawn from the depositions taken in this matter, the exhibits filed, and the findings of the Court of Claims.

The termination clause in the lease was never exercised.

Respondent Bull Run Mining Co., Inc., was engaged in mining coal in West Virginia under a lease agreement dated June 21, 1967, between it, as lessee, and Preston County Coal and Coke Corporation, as lessor. The lease was for a five-year term and if all of the coal had not been removed at the end of the five years, Respondent had the option to renew the lease for an additional five-year term. The Respondent, at the present time, is still mining coal under a second five-year renewal of the said lease agreement. Pursuant to the terms of the lease, Respondent was authorized to extract and dispose of the coal underlying the leased premises to whomever and at what pieces it chose, without any restrictions; however, during its taxable year ended September 30, 1974, the

Respondent sold all of the coal it mined to the lessor.[3] The proceeds from the sale of the coal represent the sole source of revenue from which Respondent could recover any rents and royalties paid to the lessor for the right to mine (Bull Run Pet. ¶ ¶ 3, 5 and 7; Bull Run Pet. Ex. A).

ARGUMENT

I.

THERE IS NO CONFLICT EXCEPT WITH THE COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioner correctly states that the instant cases are squarely in conflict with the decision of the Court of Appeals for the Third Circuit in *Whitmer v. Commissioner*, 443 F.2d 170 (1971).[4] Petitioner is in error, however, in attempting by the use of the word "similarly" (Petition for a Writ of Certiorari, page 8) to persuade this Court that there is a substantial divergence of authority elsewhere concerning the issue herein presented.

In the nine years since *Whitmer* was decided, no other Circuit Court has followed it. The decisions of the Fourth, Fifth, Sixth, Ninth and Tenth Circuits cited by

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[3]This is not a ground relied on by the Government in denying depletion.

[4]In *Costantino v. Commissioner*, 445 F.2d 405 (3d Cir. 1971), however, taxpayer was a contractor hired by the lessee, who agreed to pay her $2.60 per ton for each ton of coal mined and removed from lessee's premises and delivered to lessee's tipple. Taxpayer was not required to pay a minimum or advance royalty, and she was not required to mine the coal to exhaustion but only to excavate the coal as far as "practicable" (*id.*, at 406, 409) [Lease set out in Tax Court opinion, 29 TCM 189-90 (1970)].

Petitioner are all distinguishable, and most of them involve coal contractors rather than lessees. These cases are briefly summarized in Appendix B, pages 15a-17a.

Although the United States Tax Court, in the past, has agreed with the Court of Appeals for the Third Circuit in several cases involving thirty (30)-day and sixty (60)-day cancellation clauses, it has recently expressed considerable doubt as to the correctness of its position. In *Weaver v. Commissioner*, 72 T.C. 594 (1979),[5] the Tax Court held (in an opinion critical of *Whitmer*) that a one hundred twenty (120)-day notice period did not preclude the allowance of depletion to a lessee where the circumstances of the case indicated that such notice period "was longer than nominal and had sufficient economic significance to give the petitioner a capital interest in minerals in place" (*id.*, at 608-9). In rejecting the Commissioner's position of denying depletion on this lease, the court admitted to a desire "to avoid significantly expanding the effect of our controversial position by defining a nominal notice period more broadly than we have heretofore had to do" (*id.*, at 609).

II.

THE IMPACT ON THE REVENUE INVOLVED IN THIS ISSUE IS NEGLIGIBLE.

Admitting that it did not petition for a writ of certiorari to review the practically identical decision[6] of the Court of Claims in *Bakertown Coal Company, Inc. v. United States*, 202 Ct. Cl. 842, 485 F.2d 633 (1973) –

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[5]No appeal was filed by the Government in *Weaver*, and the appeal period has expired.

[6]Petitioner refers to "a divided en banc court" (Petition for a Writ of Certiorari, page 6). Actually, the decision was 6-1 in favor of the taxpayer-lessee.

involving the same lessor and identical leases as in the Black Hawk case – Petitioner claims that "the effect of a short notice termination clause in a mineral lease upon the lessee's entitlement to the depletion deduction has assumed greater administrative importance" since 1973 (Petition for a Writ of Certiorari, page 9).[7] Petitioner cites advice from the Internal Revenue Service that fifteen (15) cases pending administratively or in the district courts involve a total potential revenue loss of approximately $2.2 million.[8]

This figure is somewhat less than impressive, in view of total receipts from Federal income taxes of $322.9 *billion* in the fiscal year ending September 30, 1979,[9] and total estimated Federal income tax receipts of $315.7 *billion* in the fiscal year ending September 30, 1980.[10] Furthermore, if Petitioner intends to award to the lessor the depletion deduction claimed by the lessee (as suggested in the Petition for a Writ of Certiorari, page 17), it would appear that the resolution of this issue as urged by Petitioner would have no revenue effect whatsoever.

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[7]Petitioner neglects to mention *Thornberry Construction Company, Inc. v. United States*, 217 Ct.Cl. 196, 576 F.2d 346 (1978), which involved a similar issue, and in which no petition for a writ of certiorari was filed by the Government.

[8]Respondents' request to the Government for details on these cases has been answered by the filing, on April 18, 1980, of a Supplemental Memorandum stating that the total potential revenue loss is only $1,048,888.00, and that only twelve (12) cases are involved (two pending in the U.S. Court of Claims, four in the U.S. Tax Court, and six administratively). Petitioner still fails to state whether these cases involve lessees, contractors, or licensees.

[9]Source: *Annual Report of Commissioner of Internal Revenue for Fiscal Year 1979.*

[10]Source: *Fiscal Year 1981 Budget Revisions* (March 31, 1980).

Petitioner's claim that "the impact of the decision below upon the revenue can be expected to increase" because of the Service's announcement, in Rev. Rul. 77-481, 1977-2 Cum. Bull. 205, that it will not follow the *Bakertown* decision (Petition for a Writ of Certiorari, page 9), is unexplained, unsupported, and not understandable.

Since the *Bakertown* decision in 1973, most coal companies, both large and small, have been able to delete the thirty (30)-day terminability provisions in their leases, thus eliminating the question herein presented as a viable issue meeting the test of exceptional importance indicated by Rule 19(1) of the Rules of this Court.

III.

THE DECISION OF THE COURT OF CLAIMS IS IN HARMONY WITH APPLICABLE DECISIONS OF THIS COURT.

The decision of the Court of Claims in no respect conflicts with applicable decisions of this Court. The attributes of ownership of the coal in place possessed by Respondents are the same as those which this Court has repeatedly held to be the essential factors for the possession of a depletable, or "economic," interest in the mineral in place.

The final and authoritative word concerning the requisites of an "economic interest" was given by this Court in *Paragon Jewel Coal Company, Inc. v. Commissioner,* 380 U.S. 624 (1965). The issue was whether the lessee of coal lands was entitled to percentage depletion on all the gross income derived from the sale of the coal mined from its leases, or whether contract miners who did the actual mining acquired a depletable interest, within the meaning of Sections 611 and 613(b)(4) of the Internal

Revenue Code of 1954, to the extent that they were paid by the lessee for mining and delivering coal to it.

The Court held that the lessee of the coal lands was entitled to the entire percentage depletion allowance, and accordingly denied the claims of the contractors for a portion of such allowance, despite the fact that the contracts were "silent regarding termination and were apparently for an indefinite period" (*id.*, at 630). It is plain from this statement, as well as the Court's reference to the terminability factor in *Parsons v. Smith,* 359 U.S. 215 (1959) (380 U.S., at 634), that the Court did not regard the presence or absence of terminability as a determining factor in assessing, and denying, the contractors' claims to a portion of the percentage depletion allowance.

The crucial factor in the Court's denial of any depletion deduction to the contractors in *Paragon* was that they had not acquired an interest in the coal in place and had not secured income derived from the extraction of the coal to which they had to look for a return of their capital, but instead had to look solely to the personal covenant of the lessee (Paragon) for payment of the agreed upon fee regardless of the condition of the market at the time of the particular delivery of coal (380 U.S., at 635). The Court further pointed out that – unlike the owners of upland drill sites in *Commissioner v. Southwest Exploration Co.,* 350 U.S. 308 (1956), through whose land a State statute required the State's offshore oil to be extracted – the contractors were not essential parties to Paragon's lease but were wholly disassociated from it, received no fixed percentage of the net income from such lease, and looked not to the coal but to Paragon for their payment (*id.*, at 637-8).

The decision of the Court of Claims also accords with the principles of *Parsons v. Smith, supra.* There the Court denied depletion allowances to coal contractors who based their claims thereto upon an asserted legal fiction – namely, that their contractual right to mine coal from the designated lands and the use of their equipment, organizations and skills in doing so, should be regarded as the making of a capital investment in, and the acquisition of an economic interest in, the coal in place. The Court held that this asserted fiction was negated by seven facts (359 U.S., at 225). Respondents in the instant cases satisfy each and every condition which the contractors in *Parsons* failed to satisfy, with the sole exception of the terminability factor.

By holding in *Paragon, supra,* that the absence of a right to terminate on short notice on the part of the lessee did not confer an economic interest on the contractors, in the absence of the other factors listed in *Parsons,* this Court indicated by clear implication that the factor of terminability (on the part of either party) on short notice was irrelevant to the determination of whether a particular party possessed an economic interest.

Unlike in *Paragon* and *Parsons,* it is the lessees, and not contractors, who are claiming depletion in the instant cases.

Petitioner's reliance on *Helvering v. Bankline Oil Co.,* 303 U.S. 362 (1938), is misplaced. There the taxpayer had contracts with producers of natural gas, allowing the taxpayer to extract the gasoline from the gas owned by the producers and pay the producers 33-1/3% of the total gross proceeds derived from the sale of such gasoline, or at the option of the producers to deliver to the latter 33-1/3% of the salable gasoline so extracted. The Court disallowed the depletion allowance to the tax-

payer, holding that it had obtained, through its contracts, "an economic advantage from the production of gas," but "had no interest in the gas in place . . . had no capital investment in the mineral deposit which suffered depletion. . . ." (*id.*, at 368). There is no mention whatsoever in the opinion of the element of terminability, or even of the time period for which the contracts were made. Furthermore – unlike the instant cases – the taxpayer "had no interest as lessor or lessee, or as sub-lessor or sub-lessee, in any of the producing wells" (*id.*, at 366).

The "economic interest" language of Treasury Regulations Section 1.611-1(b) was adopted almost literally from the language of the opinion in the *Bankline* case, and has remained virtually unchanged since the regulations on this subject were first issued under the Internal Revenue Code of 1939 (Treas. Reg. 103, Section 19.23 (m)-1). These regulations have never contained any provision, or even a suggestion, of a requirement of non-terminability in order for a lessor or a lessee to be entitled to his equitably apportioned share of the depletion allowance, in accordance with Section 611(b)(1) of the Internal Revenue Code of 1954, *supra*, p. 3 and its predecessor statutory provisions.

Even before the Congress provided for equitable apportionment of the depletion allowance between lessor and lessee (Section 214(a)(10), Revenue Act of 1918, c. 18, 40 Stat. 1058, 1068, which is the predecessor of Section 611(b)(1), 1954 Code), this Court recognized that a lessee had an investment in minerals in place, and held (under the Revenue Act of 1916, c. 463, 39 Stat. 756, 757-8, 765, 767, Sections 2, 10 and 12(a)), that both the lessor and the lessee, where there was a mineral lease in effect, were entitled to a deduction for depletion "according to the value of the interest of each in the

property" (*Lynch v. Alworth-Stephens Company*), 267 U.S. 364, 369 (1925).[11]

Section 1.611-1(c)(2) of Treasury Regulations, entitled "Special Rules - Leases," *supra*, p. 5 (which presumably represents the Commissioner's official interpretation of Section 611(b)(1) of the 1954 Code) contains no provision or suggestion that the depletion deduction to which a lessor, a lessee, or any other possessor of an economic interest is entitled, is in any way dependent upon terminability or non-terminability of his interest on short notice. It is significant that, since the *Bakertown* case, *supra*, p. 12, was decided in 1973, the Treasury has made no move to modify either this regulatory provision or Treasury Regulations Section 1.611-1(b) ("Economic interest"), *supra*, p. 4, and App. C, Petition for a Writ of Certiorari, pp. 24a-25a, so as to exclude from the depletion deduction terminable leases like those involved in the instant cases.

Citing *Commissioner v. Southwest Exploration Co.*, *supra*, p. 15, Petitioner asserts that:

> If the market price of the minerals rises above the lessor's royalty, the lessor will assuredly exercise his right to terminate the lease on short notice and will either enter into a more profitable lease or extract the mineral himself and sell it. [Petition for a Writ of Certiorari, page 15.]

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[11] The now obsolete G.C.M. 26290, 1950-1 Cum. Bull. 42 (See Rev. Rul. 70-277, 1970-1 Cum. Bull. 280), cited and relied upon by Petitioner (Petition for a Writ of Certiorari, page 12), cited *Alworth-Stephens* with approval, and neither explicitly stated nor implied that lessees were required to have leases which were not terminable by their lessors for at least a year, in order to qualify for depletion deductions.

There is a total absence in the record of any basis for this assertion. On the contrary, as far as Black Hawk Coal Corporation is concerned, the lessee mined coal continuously from the time the lease was executed in 1964, through the taxable years in question (1970, 1972, and 1972), and until the minable coal was exhausted in 1976, without having its lease terminated by the lessor (Stipulation of Facts, ¶¶ 2, 3, 4, 5, and 7). This was true even though coal prices rose dramatically, especially during the oil crises of 1973 and 1974. Similarly, in neither the Swank case nor the Bull Run case was any lease ever terminated by action of the lessor.

The lessee receives percentage depletion only if it sells the coal. Mining without sale is not sufficient, since depletion is based on the gross income from the property, exclusive of rents or royalties paid by the lessee (Section 613(a), Internal Revenue Code of 1954). Contrary to Petitioner's assertion, the "economic reality" is that Respondents did mine and sell the coal on which they claimed depletion; the "legal abstraction" is the lessors' unexercised right of termination.

Additionally, the relevant decisions of this Court, noted above, clearly indicate that a lessee otherwise entitled to an allowance for percentage depletion remains entitled thereto with respect to coal extracted under the lease, unless and until the lessor exercises his right of termination.

IV.

RESPONDENTS ARE ENTITLED TO PERCENTAGE DEPLETION AS THE ONLY POSSIBLE APPLICANTS FOR IT.

If Respondents are not entitled to the allowance for percentage depletion, there will be no depletion allowed on the coal mined under these leases. In the case of Black Hawk, where the actual mining of the coal was done by independent contractors employed by Black Hawk (the lessee) for this purpose, no claim for percentage depletion has been made by either Black Hawk's lessor or its contractors (Stipulation of Facts, ¶ 9). In the case of Bull Run, the lessor did not claim depletion (Lindsley Deposition, page 9). The lessor did take capital gains on royalties under Section 631(c), Internal Revenue Code of 1954 (*id.*, 16). In the case of Swank, the lessor was a county government, and therefore had no reason to claim depletion. (Statement of the Case, *supra,* p. 6.)

The denial of percentage depletion to Respondents where, as in these cases, there are no other possible claimants, would bring about an untenable and inequitable result, clearly contrary to the intention of the Congress in enacting the "equitable apportionment" provision, Section 611(b)(1), Internal Revenue Code of 1954, *supra,* p. 3.

The deduction for percentage depletion is mandatory in all cases where it exceeds cost depletion, and it must be computed on the basis of an arbitrary percentage (in the case of coal, 10%) of the "gross income from the property" (Section 613, Internal Revenue Code of 1954). In 1951, the Congress provided capital gains treatment for the recipients of coal royalties, in lieu of percentage depletion (Revenue Act of 1951, Section 325,

P.L. 183, 65 Stat. 452, 501-2, the predecessor of Section 631(c) of the Internal Revenue Code of 1954).

Ever since that time, only lessees of coal lands and others similarly situated – *i.e.*, those who have acquired an "economic interest" through arrangements other than leases – are entitled to any amount of percentage depletion. Both Section 631(c) of the 1954 Code (Appendix A, p. 2a) and §1.611-1(b)(2) of the Treasury Regulations, *supra*, p. 4, clearly specify that coal lessors and sublessors not actively engaged in the mining or preparation of coal are entitled to capital gains treatment instead of percentage depletion.

It is not within the province of the Commissioner, contrary to the statutory provisions above cited, to completely eliminate depletion on a portion of the gross income from the coal property – that is, on the difference between the selling price of the coal and the royalty paid by the lessee to the lessor – as he has attempted to do in these cases. Neither is it appropriate for the Commissioner to reallocate such portion of the depletion allowance from the lessee to the lessor, as Petitioner appears to suggest (Petition for a Writ of Certiorari, page 17).

In *Paragon Jewel Coal Company, Inc. v. Commissioner, supra,* pp. 14-16, this Court thoroughly considered the provisions of Section 631(c), Internal Revenue Code of 1954, and clearly indicated that "an owner who by contract disposes of the coal in place while retaining an economic interest is relegated to capital gains treatment of the royalties received," unless he is actively engaged in the mining of coal, in which case he is entitled to percentage depletion (380 U.S., at 636-7). By no possible interpretation of the statutory provisions could any of the lessors in the instant cases be considered to be within the "exemptive language in Section 631(c)," referred to by

the Court in *Paragon* (*ibid.*), so as to be entitled to any portion of the percentage depletion allowance on the coal mined from the leases.

CONCLUSION

The Petition for a Writ of Certiorari should be denied.

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APPENDIX

APPENDIX A

(1) Internal Revenue Code of 1954 (26 U.S.C.)

Section 613(c). Percentage Depletion. Definition of Gross Income From Property.

(c) Definition of Gross Income From Property. – For purposes of this section –

(1) Gross Income From The Property. – The term "gross income from the property" means, in the case of a property other than an oil or gas well and other than a geothermal deposit, the gross income from mining.

(2) Mining. – The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

(3) Extraction of the Ores or Minerals From the Ground. – The term "extraction of the ores or minerals from the ground" includes the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining. The preceding sentence shall not apply to any such extraction of the mineral or ore by a purchaser of such waste or residue or of the rights to extract ores or minerals therefrom.

(4) Treatment Processes Considered as Mining. – The following treatment processes where applied by

the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611:

(A) In the case of coal – cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

* * * * *

Section 631(c). Disposal of Coal or Domestic Iron Ore With a Retained Economic Interest.

(C) Disposal of Coal or Domestic Iron Ore With a Retained Economic Interest. – In the case of the disposal of coal (including lignite), or iron ore mined in the United States, held for more than 1 year before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal or iron ore, the difference between the amount realized from the disposal of such coal or iron ore and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272 shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal or iron ore. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal or iron ore. This subsection shall not apply to income realized by any owner as a co-adventurer, partner, or principal in the mining of such coal or iron ore, and the word "owner" means any person who owns an economic interest in coal or iron ore in place, including a sublessor. The date of disposal of such coal or iron ore shall be deemed to be the date such coal or iron ore is mined. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions

allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. This subsection shall have no application, for purposes of applying subchapter G, relating to corporations used to avoid income tax on shareholders (including the determinations of the amount of the deductions under section 535(b)(6) or section 545(b)(5)). This subsection shall not apply to any disposal of iron ore –

(1) to a person whose relationship to the person disposing of such iron ore would result in the disallowance of losses under section 267 or 707(b), or

(2) to a person owned or controlled directly or indirectly by the same interests which own or control the person disposing of such iron ore.

(2) Treasury Regulations on Income Tax (26 C.F.R.)

Section 1.272-1. Expenditures relating to disposal of coal or domestic iron ore.

(a) *Introduction.* Section 272 provides special treatment for certain expenditures paid or incurred by a taxpayer in connection with a contract (hereafter sometimes referred to as a "coal royalty contract" or "iron ore royalty contract") for the disposal of coal or iron ore the gain or loss from which is treated under section 631(c) as a section 1231 gain or loss on the sale of coal or iron ore. See paragraph (e) of §1.631-3 for special rules relating to iron ore. The expenditures covered by section 272 are those which are attributable to the making and administering of such a contract or to the preservation of the economic interest retained under the contract. For examples of such expenditures, see paragraph (d) of this section. For a taxable year in which gross royalty income is realized under the contract of disposal, such expendi-

tures shall not be allowed as a deduction. Instead, they are to be added to the adjusted depletion basis of the coal or iron ore disposed of in the taxable year in computing gain or loss under section 631(c). However, where no gross royalty income is realized under the contract of disposal in a particular taxable year, such expenditure shall be treated without regard to section 272.

(b) *In general.* (1) Where the disposal of coal or iron ore is covered by section 631(c), the provisions of section 272 and this section shall be applicable for a taxable year in which there is income under the contract of disposal. (For purposes of section 272 and this section, the term "income" means gross amounts received or accrued which are royalties or bonuses in connection with a contract to which section 631(c) applies.) All expenditures paid or incurred by the taxpayer during the taxable year which are attributable to the making and administering of the contract disposing of the coal or iron ore and all expenditures paid or incurred during the taxable year in order to preserve the owner's economic interest retained under the contract shall be disallowed as deductions in computing taxable income for the taxable year. The sum of such expenditures and the adjusted depletion basis of the coal or iron ore disposed of in the taxable year shall be used in determining the amount of gain or loss with respect to the disposal. See § 1.631-3. For special rule in case of loss, see paragraph (c) of this section. Section 272 and this section do not apply to capital expenditures, and such expenditures are not taken into account in computing gain or loss under section 631(c) except to the extent they are properly part of the depletable basis of the coal or iron ore.

(2) The expenditures covered under section 272 and this section are disallowed as a deduction only with respect to a taxable year in which income is realized under

the coal royalty contract (or iron ore royalty contract) to which such expenditures are attributable. Where no income is realized under the contract in a taxable year, these expenditures shall be deducted as expenses for the production of income, or as a business expense, or they may be treated under section 266 (relating to taxes and carrying charges) if applicable.

(3) The provisions of section 272 and this section apply to a taxable year in which income from the disposal by the owner of coal or iron ore held by him for more than 6 months is subject to the provisions of section 631(c) even though the actual mining of coal or iron ore under the coal royalty contract (or iron ore royalty contract) does not take place during the taxable year. Where the right under the contract to mine coal or iron ore for which advance payment has been made expires, terminates, or is abandoned before the coal or iron ore is mined, and paragraph (c) of § 1.631-3 requires the owner to recompute his tax with respect to such payment, the recomputation must be made without applying the provisions of section 272 and this section.

(c) *Losses.* If, in any taxable year, the expenditures referred to in section 272 and this section plus the adjusted depletion basis (as defined in paragraph (b)(2) of § 1.631.3) of the coal or iron ore disposed of during the taxable year exceed the amount realized under the contract which is subject to section 631(c) during the taxable year, such excess shall be considered under section 1231 as a loss from the sale of property used in the trade or business and, to the extent not availed of as a reduction of gain under that section, shall be a loss deductible under section 165(a) (relating to the deduction of losses generally).

(d) *Examples of expenditures.* (1) The expenditures referred to in section 272 include, but are not limited to, the following items, if such items are attributable to the making or administering of the contract or preserving the economic interest therein: Ad valorem taxes imposed by State or local authorities, costs of fire protection, costs of insurance (other than liability insurance), costs incurred in administering the contract (including costs of bookkeeping and technical supervision), interest on loans, expenses of flood control, legal and technical expenses, and expenses of measuring and checking quantities of coal or iron ore disposed of under the contract. Whether the interest on loans is attributable to the making or administering of the contract or preserving the economic interest therein will depend upon the use to which the borrowed monies are put.

(2) Any expenditure referred to in this section which is applicable to more than one coal royalty contract or iron ore royalty contract shall be reasonably apportioned to each of such contracts. Furthermore, if an expenditure applies only in part to the making or administering of the contract or the preservation of the economic interest, then only such part shall be treated under section 272. The apportionment of the expenditure shall be made on a reasonable basis. For example, where a taxpayer has other income (such as income from oil or gas royalties, rentals, right of way fees, interest, or dividends) as well as income under section 631(c), and where the salaries of some of its employees or other expenses relate to both classes of income, such expenses shall be allocated reasonably between the income subject to section 631(c) and the other income. Where a taxpayer has more than one coal royalty contract or iron ore royalty contract, expenditures under this section relating to a contract from which no income has been received in the taxable year

may not be allocated to income from another contract from which income has been received in the taxable year.

Section 1.612-1. Basis for allowance of cost depletion.

(a) *In general.* The basis upon which the deduction for cost depletion under section 611 is to be allowed in respect of any mineral or timber property is the adjusted basis provided in section 1011 for the purpose of determining gain upon the sale or other disposition of such property except as provided in paragraph (b) of this section. The adjusted basis of such property is the cost or other basis determined under section 1012, relating to the basis of property, adjusted as provided in section 1016, relating to adjustments to basis, and the regulations under such sections. In the case of the sale of a part of such property, the unrecovered basis thereof shall be allocated to the part sold and the part retained.

(b) *Special rules.* (1) The basis for cost depletion of mineral or timber property does not include:

(i) Amounts recoverable through depreciation deductions, through deferred expenses, and through deductions other than depletion, and

(ii) The residual value of land and improvements at the end of operations.

In the case of any mineral property the basis for cost depletion does not include amounts representing the cost or value of land for purposes other than mineral production. Furthermore, in the case of certain mineral properties, such basis does not include exploration or development expenditures which are treated under section 615(b) or 616(b) as deferred expenses to be taken into account as deductions on a ratable basis as the units of minerals benefited thereby are produced and sold. However, there shall be included in the basis for cost depletion of oil and gas property the amounts of capitalized

drilling and development costs which, as provided in §1.612-4, are recoverable through depletion deductions. In the case of timber property, the basis for cost depletion does not include amounts representing the cost or value of land.

(2) Where a taxpayer elects to treat the cutting of timber as a sale or exchange of such timber, the basis for cost depletion shall be the fair market value of such timber as of the first day of the taxable year in which such timber is cut and such value shall be considered for such taxable year and all subsequent taxable years as the cost of such timber for all purposes for which such cost is a necessary factor. See section 631(a).

(c) *Cross references.* In cases where the valuation, revaluation, or mineral content of deposits is a factor, see paragraphs (c), (d), (e), and (f) of §1.611-2. In cases where the valuation, revaluation, or quantity of timber is a factor, see paragraphs (e), (f), and (g) of §1.611.3. For definitions of the terms "property", "fair market value", "mineral enterprise", "mineral deposit", and "minerals", see paragraph (d) of §1.611-1. For rules with respect to treatment of depletion accounts on taxpayer's books, see paragraph (b) of §1.611-2 in the case of mineral property, and paragraph (c) of §1.611-3 in the case of timber property.

Section 1.613-1. Percentage depletion; general rule.

In the case of a taxpayer computing the deductions for depletion under section 611 with respect to minerals on the basis of a percentage of gross income from the property, as defined in section 613(c), § 1.613-3, and § 1.613-4, such deduction shall be the percentage of such gross income as specified in section 613(b) and § 1.613-2. The deduction shall not exceed 50 percent

of the taxpayer's taxable income from the property (computed without allowance for depletion). Such taxable income shall be computed in accordance with § 1.613-5. In no case shall the deduction for depletion computed under this section be less than the deduction computed upon the cost or other basis of the property provided in section 612 and the regulations thereunder. The apportionment of the deduction between the several owners of economic interests in a mineral deposit will be made as provided in paragraph (c) of § 1.611-1. For rules with respect to "gross income from the property" and for definition of the term "mining," see §§ 1.613-3 and 1.613-4. For definitions of the terms "property," "mineral deposit," and "minerals," see paragraph (d) of § 1.611-1.

Section 1.631-3. Gain or loss upon the disposal of coal or domestic iron ore with a retained economic interest.

(a) *In general.* (1) The provisions of section 631(c) apply to an owner who disposes of coal (including lignite), or iron ore mined in the United States, held for more than 6 months before such disposal under any form or type of contract whereby he retains an economic interest in such coal or iron ore. The difference between the amount realized from disposal of the coal or iron ore in any taxable year, and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272, shall be gain or loss upon the sale of the coal or iron ore. See paragraph (b)(4) of this section for the definition of "owner." See paragraph (3) of this section for special rules relating to iron ore.

(2) In the case of such a disposal, the provisions of section 1231 apply, and the coal or iron ore shall be considered to be property used in the trade or business

for the taxable year in which it is considered to have been sold, along with other property of the taxpayer used in the trade or business as defined in section 1231(b), regardless of whether the coal or iron ore is property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Whether gain or loss resulting from the disposition of the coal or iron ore which is considered to have been sold will be deemed to be gain or loss resulting from a sale of a capital asset held for more than 6 months will depend on the application of section 1231 to the taxpayer for the taxable year; *i.e.*, if the gains do not exceed the losses, they shall not be considered as gains and losses from sales or exchanges of capital assets but shall be treated as ordinary gains and losses.

(b) *Rules for application of section.* (1) For purposes of section 631(c) and this section, the date of disposal of the coal or iron ore shall be deemed to be the date the coal or iron ore is mined. If the coal or iron ore has been held for more than 6 months on the date it is mined, it is immaterial that it had not been held for more than 6 months on the date of the contract. There shall be no allowance for percentage depletion provided in section 613 with respect to amounts which are considered to be realized from the sale of coal or iron ore under section 631(c).

(2) The term "adjusted depletion basis" as used in section 631(c) and this section means the basis for allowance of cost depletion provided in section 612 and the regulations thereunder. Such "adjusted depletion basis" shall include exploration or development expenditures treated as deferred expenses under section 615(b) or 616(b), or corresponding provisions of prior income tax laws, and be reduced by adjustments under section

1016(a)(9) and (10), or corresponding provisions of prior income tax laws, relating to deductions of deferred expenses for exploration or development expenditures in the taxable year or any prior taxable years. The depletion unit of the coal or iron ore disposed of shall be determined under the rules provided in the regulations under section 611, relating to cost depletion.

(3)(i) In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties (except rents and royalties paid by a lessee with respect to coal or iron ore disposed of by the lessee as an "owner" under section 631(c)) shall be determined without regard to the provisions of section 631(c). Thus, the amounts of rents and royalties paid or incurred by a lessee with respect to coal or iron ore shall be excluded from the lessee's gross income from the property for the purpose of determining his percentage depletion without regard to the treatment of such rents or royalties in the hands of the recipient under this section. See section 613 and the regulations thereunder.

(ii) (*a*) However, a lessee who is also a sublessor may dispose of coal or iron ore as an "owner" under section 631(c). Rents and royalties paid with respect to coal or iron ore disposed of by such a lessee under section 631(c) shall increase the adjusted depletion basis of the coal or iron ore and are not otherwise deductible.

(*b*) The provisions of this subdivision may be illustrated by the following example:

Example. B is a sublessor of a coal lease; A is the lessor; and C is the sublessee. B pays A a royalty of 50 cents per ton. C pays B a royalty of 60 cents per ton. The amount realized by B under section 631(c) is 60 cents per ton and will be reduced by the adjusted deple-

tion basis of 50 cents per ton, leaving a gain of 10 cents per ton taxable under section 631(c).

(4)(i) The provisions of this section apply only to an owner who has disposed of coal or iron ore and retained an economic interest. For the purposes of section 631(c) and this section, the word "owner" means any person who owns an economic interest in coal or iron ore in place, including a sublessor thereof. A person who merely acquires an economic interest and has not disposed of coal or iron ore under a contract retaining an economic interest does not qualify under section 631(c). A successor to the interest of a person who has disposed of coal or iron ore under a contract by virtue of which he retained an economic interest in such coal or iron ore is also entitled to the benefits of this section. Section 631(c) and this section shall not apply with respect to any income realized by any owner as co-adventurer, partner, or principal in the mining of such coal or iron ore.

(ii) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A owns a tract of coal land in fee. A leases to B the right to mine all the coal in this tract in return for a royalty of 30 cents per ton. B subleases his right to mine coal in this tract to C, who agrees to pay A 30 cents per ton and to pay to B an additional royalty of 10 cents per ton. Section 631(c) applies to the royalties of both A and B, if the other requisites of the section have been met.

Example (2). Assume the same facts as in example (1), except that A dies leaving his royalty interest to D. D has an economic interest in the coal in place and qualifies for section 631(c) treatment with respect to his share of the royalties since he is a successor in title to A.

Example (3). Assume the same facts as in example (1), except that E agrees to pay a sum of money to C in return for 10 cents per ton on the coal mined by C. E has an economic interest, since he must look solely to the extraction of the coal for the return of his investment. However, E has not made a disposal of coal under a contract wherein he retains an economic interest, and, therefore, does not qualify under section 631(c). E is entitled to depletion on his royalties.

(c) *Payments received in advance of mining.* (1)(i) Where the conditions of paragraph (a) of this section are met, amounts received or accrued prior to mining shall be treated under section 631(c) as received from the sale of coal or iron ore if the contract of disposal provides that such amounts are to be applied as payment for coal or iron ore subsequently mined. For example, advance royalty payments or minimum royalty payments received by an owner of coal or iron ore qualify under section 631(c) where the contract of disposal grants the lessee the right to apply such royalties in payment of coal or iron ore mined at a later time.

(ii) The provisions of this subparagraph may be illustrated by the following example:

Example. A acquires coal rights on January 1. On January 30, A enters into a contract of disposal providing that mining shall begin July 2, and mining actually begins no earlier. Any advance payments which A receives qualify under section 631(c).

(2) However, if the right to mine coal or iron ore under the contract expires, terminates, or is abandoned before the coal or iron ore which had been paid for is mined, the taxpayer shall treat payments attributable to the unmined coal or iron ore as ordinary income and not as received from the sale of coal or iron ore under section 631(c). Accordingly, the taxpayer shall recompute his

tax liability for the taxable year in which such payments were received. The recomputation shall be made in the form of an amended return where necessary.

(3) Bonuses received or accrued by an owner in connection with the grant of a contract of disposal shall be treated under section 631(c) as received from the sale of coal or iron ore to the extent attributable to coal or iron ore held for more than 6 months. The rules contained in paragraph (d) of § 1.631-2 relating to bonuses in the case of contracts for the disposal of timber shall be equally applicable in the case of bonuses received for the grant of a contract of disposal of coal or iron ore under this section.

APPENDIX B

Cases from Fourth, Fifth, Sixth, Ninth, and Tenth Circuits on "Economic Interest"

United States v. Stallard, 273 F.2d 847 (4th Cir. 1959), and *McCall v. Commissioner,* 312 F.2d 699 (4th Cir. 1963), are distinguishable on their facts from the present cases and thus provide little support for Petitioner's position. In *Stallard* the court denied depletion deductions to members of a partnership engaged in the strip mining of coal under a contract with the owners of coal-bearing land. The agreement provided that the partnership should furnish the mining equipment and should mine and deliver the coal to the landowners at a fixed price per ton. The latter had the right to cancel the contract at any time upon the giving of thirty (30)-days' written notice. It is clear from the opinion that the court did not rely solely on short-term terminability in denying depletion deductions to the contractors, though it accorded considerable weight to that factor. In *McCall* the court also held that coal contractors whose contract could be terminated without cause upon thirty (30)-days' written notice by the lessee who hired them were not entitled to percentage depletion; but there, too, the claimants possessed no legal interest in the coal in place and were required under their contract to deliver all coal mined to the lessee at a fixed price per ton.

United States v. Wade, 381 F.2d 345 (5th Cir. 1967), involved a contract miner who was entitled to be paid by the owner of dolomite in place a fixed amount per ton for quarrying the mineral and delivering it to the owner. In denying depletion to the contract miner, the court expressly stated that the contract was not a mineral lease or a grant of minerals, and that nothing in its

terms indicated any intention to convey a right or interest in dolomite in place (*id.*, at 350, n.7), and clearly regarded the factor of terminability for cause on thirty (30)-days' notice as being of only incidental importance. Furthermore, the owner of the dolomite in place had claimed, and had been held by the District Court to be entitled to, the entire depletion allowance under the same mining contract with Wade (*id.*, at 351).

In *Winters Coal Co., Inc. v. Commissioner,* 496 F.2d 995 (5th Cir. 1974) [*reversing* 57 T.C. 249 (1971)], the court allowed depletion to a lessee under a one-year coal stripping lease, which was terminable by either party on thirty (30)-days' notice, where the lessee was required to and did acquire surface rights. The writer of the opinion, citing *Bakertown* (*supra,* p. 12) with approval, determined that short-notice terminability did not disqualify an otherwise depletable leasehold interest (*id.*, at 997-8, 1000). The other two judges on the panel did not reach that issue, but held that the lease was depletable because of the lessee's surface rights (*ibid.*).

Ramey v. Commissioner, 398 F.2d 478 (6th Cir. 1968), involved a situation where the owner of the coal-bearing land was also the sole purchaser of the coal. The Court of Appeals for the Sixth Circuit approved the findings of the Tax Court to the effect that the landowner did not intend to surrender any capital interest in the coal to the taxpayer and that an alleged royalty paid under an agreement with the landowner was no more than an offset or reduction in the price paid for the coal, and accordingly denied depletion.

In *Usibelli v. Commissioner,* 229 F.2d 539 (9th Cir. 1955), the unsuccessful claimant of percentage depletion mined coal for the U.S. Army under contract, the coal belonged to the Army, payment prices depended on min-

ing costs, rather than on the market price of the coal, and the taxpayer could mine only limited amounts as permitted by the Government.

In *Rissler & McMurry Co., Inc. v. United States,* 480 F.2d 684 (10th Cir. 1973), the court denied a depletion allowance to a construction company which built and paved roads for a city, under a contract whose bid specification contained a provision that the successful bidder could use a gravel pit owned by the city as a source of construction material upon payment of two cents per ton or three cents per cubic yard, and where the city and taxpayer later made an oral agreement under which minor amounts of the material were sold by the taxpayer to other parties upon approval by the city council and payment of a royalty. The case is clearly distinguishable from the cases at bar, in that the contract reflected no intention by the city to surrender its interest in the gravel and the taxpayer did not look solely to the extraction of the gravel for a return of its investment.

Supreme Court, U. S.
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No. 79-1515

In the Supreme Court of the United States

OCTOBER TERM, 1979

UNITED STATES OF AMERICA, PETITIONER

v.

ELWOOD SWANK AND RITA SWANK

UNITED STATES OF AMERICA, PETITIONER

v.

BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA, PETITIONER

v.

BULL RUN MINING CO., INC.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

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BRIEF FOR THE UNITED STATES

QUESTION PRESENTED

Whether a provision in a mineral lease permitting the lessor to terminate the lease on 30 days' notice without cause deprives the lessee of an economic interest in the minerals in place so that the lessee is not entitled to a depletion deduction under Sections 611(a) and 613 of the Internal Revenue Code of 1954.

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Revenue Act of 1918, ch. 18, 40 Stat. 1057 *et seq.*:
Section 214(a)(10), 40 Stat. 1068 11
Section 234(a)(9), 40 Stat. 1078 11
Revenue Act of 1926, ch. 27, Section 204(c), 44 Stat. 9 12

Miscellaneous:

G.C.M. 26290, 1950-1 Cum. Bull. 42 ..... 20, 22
Rev. Rul. 70-277, 1970-1 Cum. Bull. 280 20
Sneed, "*The Economic Interest*," 35 Tex. L. Rev. 314 (1957) 12
Treasury Regulations on Income Tax (26 C.F.R.):
Section 1.611-1 1
Section 1.611-1(a)(1) 10, 1a-2a
Section 1.611-1(b)(1) 13, 14, 2a
Section 1.611-2(a) 13

OPINION BELOW

The opinion of the Court of Claims (Pet. App. 1a–16a) is reported at 602 F.2d 348.

JURISDICTION

The judgment of the Court of Claims was entered on November 30, 1979, in *Swank* (Pet. App. 17a–18a). The judgments of that court were entered on December 7, 1979, in *Bull Run Mining Co.* and *Black Hawk Coal Corporation* (Pet. App. 19a–22a). By order dated February 21, 1980, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including March 29, 1980. The petition was filed on March 27, 1980, and was granted on May 12, 1980 (J.A. 117a). The jurisdiction of this Court rests on 28 U.S.C. 1255.

STATUTE AND REGULATION INVOLVED

The pertinent provisions of Sections 611 and 613 of the Internal Revenue Code of 1954 (26 U.S.C.) and of Treasury Regulations on Income Tax, Section 1.611–1 (26 C.F.R.), are set forth in the Appendix, *infra*, 1a–2a.

STATEMENT

1. a. *Swank*. During 1966–1967, respondent Swank[1] was engaged in mining anthracite coal on various tracts located in Northumberland County, Pennsylvania. At this time, Northumberland County owned more than 17,500 acres of land in the county which it had acquired at various tax sales (J.A. 52a–53a). Swank had leased one of these

[1] References to respondent or Swank are to Elwood Swank. Rita Swank is a party solely because she filed joined federal income tax returns with her husband for the years in issue.

tracts from Northumberland County under a lease agreement dated October 24, 1964 (J.A. 52a).

Respondent engaged in deep mining operations on this property until May 1968. At that time, heavy rains precipitated a mountain slide which forced him to close the mine. Respondent's deep mining methods included the excavation of shafts through the overburden, the extraction of coal by means of explosives, picks and shovels, the transportation of the coal to the surface, and the conveyance of the coal to Swank's breakers where it was cleaned and sorted for sale to the general public (J.A. 52a).

During this period respondent leased a second tract of land from the County. Under the terms of a lease agreement dated July 25, 1966, respondent agreed to engage in strip mining operations on 133 acres owned by the County. He strip mined on this tract in both 1966 and 1967. Respondent's strip mining operations involved the removal of the overburden by a power shovel and the removal of the then-exposed coal seam by power equipment. The coal was then transported by truck to respondent's breakers, where it was cleaned and sorted for sale. The tract in question had previously been leased by the County to Edward Gusick. After respondent purchased certain equipment and leasehold improvements from Gusick for $12,085, the County cancelled Gusick's lease and issued a new lease to respondent.[2]

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[2]The Court of Claims found (J.A. 52a) that respondent had "bought out" Gusick's interest for $12,085, "including the assumption of remaining payments of $5,085.50 on generating equipment, and the balance for Gusick's existing excavation on the property." According to the stipulation of facts, however, Swank capitalized only $1,000 into an account covering purchased excavations. The bulk of the investment was apparently allocated to various items of mining equipment.

Pursuant to both of the leases, respondent was authorized to mine coal on lands owned by the County in exchange for a royalty of 35 cents per gross ton of coal removed.[3] Respondent could sell the coal to whomever he pleased at whatever price he could obtain (J.A. 24a, 33a, 54a). Both leases contained provisions for automatic termination if either (1) the County sold the lands; (2) the tax delinquent former owners redeemed the lands; (3) the lessee failed to mine and remove coal for 30 consecutive days absent abnormal conditions; or (4) the lessee failed to comply with the terms of the lease agreement (J.A. 26a–27a, 30a–31a, 35a–37a, 39a–40a). Moreover, each lease provided, in accordance with the County's practice with respect to all leases negotiated between January 1, 1956 and May 31, 1969, that the lessor could "terminate this agreement completely and fully without liability upon it or any further recourse against it, upon thirty days written notice given to MINER * * *" (J.A. 27a, 37a).[4]

On its federal income tax returns for 1966 and 1967, respondent claimed deductions of $41,371.24 and $15,204.32, respectively, for depletion of coal resources covered by his leases with the County of Northumberland (J.A. 8a–9a).

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[3] Pursuant to the lease agreements, respondent paid the County royalties of $7,545.10 and $6,854.05 during 1966 and 1967, respectively (J.A. 53a). Although the County reserved the right to increase the royalties as much as 5 cents per ton under the lease, it did not do so during the years at issue (J.A. 24a, 33a, 54a).

[4] This clause had been added to the County's leases in the early 1950's to counter charges that the County Commissioners had granted leases on the basis of politics. The Court of Claims found that the Northumberland County Commissioners had publicly announced that they would not terminate a mining lease except for cause because of the time and capital which a lessee would be expected to invest in mining operations. However, the Commissioners continued to retain the power to cancel a lease without cause and they would give no assurance that they could not so cancel a lease (J.A. 54a).

b. *Black Hawk Coal Corporation.* During 1970–1972, respondent Black Hawk Coal Corporation was engaged in the mining of coal on lands located in Pike County, Kentucky. The lands in question were under a lease agreement dated February 20, 1964, between Kentland Coal & Coke Company, Division of the Berwind-White Coal Mining Company, as lessor, and Eugene M. Bane, as lessee. Bane in turn assigned the lease to Black Hawk (J.A. 69a).

Pursuant to the terms of the lease agreement, Black Hawk, as lessee, was authorized to remove coal from specified lands for an unspecified term until the coal seam was exhausted, for a consideration of $5,000 per year, payable monthly, or a royalty of 25 cents per ton of coal removed, whichever was greater. The latter amount was to be credited against the monthly royalty as rental (J.A. 70a–76a, 77a–78a). The agreement permitted respondent to sell the coal which it mined to anyone. The lease agreement was terminable if Black Hawk failed to pay the required rent or royalties for a period of 60 days after the due date of such payments, of if the lease agreement or the rights subject to that agreement were assigned, levied upon, or sold without the lessor's consent under any legal proceeding, or under any adjudication of Black Hawk's bankruptcy (J.A. 80a). Finally, the lease was cancellable by either party without cause on 30 days' written notice (J.A. 85a). On its federal income tax returns for 1970–1972, Black Hawk claimed a percentage depletion deduction with respect to the coal which had been mined under the lease agreement (J.A. 71a).[5]

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[5] Black Hawk hired independent contractors to engage in drift mining operations on the leased land. Drift mining is an underground mining process in which a horizontal coal seam is reached by clearing away part of the mountainside by bulldozer, after which two parallel tunnels are made into the coal seam. One tunnel is used for working

c. *Bull Run Mining Co.* During its taxable year ended September 30, 1974, respondent Bull Run Mining Co., Inc., was engaged in mining coal in West Virginia, under a lease agreement, dated June 21, 1967, between it, as lessee, and Preston County Coal and Coke Corporation, as lessor (J.A. 90a). The lease was for a five-year term, which was thereafter extended for an additional five years. Pursuant to the terms of the lease, Bull Run was authorized to mine coal on specified lands for the payment of a monthly royalty of 25 cents per ton of coal removed. The lease agreement was cancellable by either party on 30 days' written notice (J.A. 94a-95a). The lease gave the lessor the first opportunity to buy the coal mined by Bull Run only if the lessor met Bull Run's price (Pet. App. 4a n.4). On its federal income tax return for its taxable year ended September 30, 1974, Bull Run claimed a depletion deduction of $39,981.41 with respect to the coal which it mined as lessee under the agreement (J.A. 92a-93a).

2. On audit of each of respondents, the Commissioner of Internal Revenue determined deficiencies in income taxes on the ground that none of them possessed a depletable economic interest in the minerals covered by their leases. The Commissioner therefore disallowed respondents' claimed depletion deductions for the taxable years at issue. After respondents paid the resulting assessments, they filed claims for refund, which the Commissioner denied. Respondents thereupon instituted these refund suits in the Court of Claims (Pet. App. 3a).

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space in the removal of the coal while the other is used for ventilation. Coal is removed as the drift mine is driven into the mountain, following the coal seam. The roof is supported by pillars of coal in place and by erected wood supports. Black Hawk paid the hired contractor who removed the coal on a fixed-dollar basis per ton. The contractors transported the coal to a tipple, where the coal was cleaned. The tipple operator purchased the coal from Black Hawk on a per-ton basis at the time of delivery (J.A. 70a).

Finding that "the cases are legally all the same" (Pet. App. 4a; footnote omitted), the Court of Claims consolidated all three cases for argument. It upheld respondents' claims for refund on the authority of its prior decision in *Bakertown Coal Co.* v. *United States*, 485 F.2d 633 (1973). There, on virtually identical facts, a divided en banc court held that lessees under comparable coal leases had an economic interest in the coal in place, thereby entitling them to the percentage depletion deduction for the coal mined. The Court of Claims adhered to its *Bakertown* decision, ruling that the fact that the lessors could have terminated the lease without cause did not deprive respondent lessees of an economic interest in the minerals in place and the depletion deduction (Pet. App. 1a–10a). As the court saw the matter, "the mere existence of the unused termination clause is not enough to deprive the taxpayer-lessees of their 'economic interest' they would otherwise admittedly have" (Pet. App. 5a). In so holding, the court acknowledged that its decision squarely conflicted with *Whitmer* v. *Commissioner*, 443 F.2d 170 (3d Cir. 1971) (Pet. App. 5a–6a).

The Court of Claims further observed that even on the assumption that the lessor's legal right to terminate the lease (rather than whether there was an actual termination) was determinative of the lessee's eligibility to the depletion deduction, it "[could] not say *a priori* [in the absence of any proof] that a month's period is too short for a miner to expect to extract a substantial amount of coal" (Pet. App. 8a). In considering the effect of a termination clause, the court therefore concluded that "[l]ike *Bakertown*, these cases do not involve leases terminable within a single day" (*ibid.*).

Finally, as in *Bakertown* (see 485 F.2d at 642), the Court of Claims believed that if respondents' claimed de-

pletion deductions were disallowed, there would be no depletion on the coal mined under these leases. Although the court acknowledged the correctness of the government's argument that every applicant for the depletion allowance must show his own entitlement, it nevertheless concluded "that Congress, in establishing percentage depletion, intended that, except for extraordinary instances, someone should be entitled to depletion on all mined coal covered by the Code provision. *Cf.* I.R.C. § 613(c)" (Pet. App. 9a). As the court concluded, "[w]here there can be no other claimant, we believe that neither the Internal Revenue Service nor the courts should be too technical or too harsh in finding the only possible applicant to be ineligible. The considerations are in some (though of course not all) respects different from the cases in which a choice has to be made among competing claimants" (*ibid.*).

SUMMARY OF ARGUMENT

1. The decisions of this Court involving eligibility for the depletion allowance uniformly require that the taxpayer establish the equivalent of an ownership interest in the minerals in place. The depletion allowance "is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production." *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366 (1938). Hence, the deduction is "designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 312 (1956).

Two decisions of this Court—*Parsons* v. *Smith*, 359 U.S. 215 (1959), and *Paragon Jewel Coal Co.* v. *Com-*

missioner, 380 U.S. 624 (1965)—establish the correctness of the rule that we urge here, *viz.*, that a mineral lessee does not have a depletable capital investment in minerals in place if the lessor can terminate the lease on short notice without cause. In both of those cases, the Court emphasized the fact that the lessor had the right to so terminate the lease. While the decisions in *Parsons* and *Paragon Jewel Coal Co.* held that the lessees' obligation to deliver the coal at a fixed price deprived them of an economic interest in the coal in place, that fact does not diminish the significance of the lessors' right to terminate on short notice or the force of the Court's analysis as applied to these cases.

The ultimate question to be addressed here is which party has a capital investment in the minerals in place. Thus, the lessor's right to terminate on short notice without cause is simply one of many factors that deprive the lessee of a depletable capital investment in minerals in place in the same fashion as the lessee's obligation to deliver the minerals to the lessor at a fixed price. In the latter case, *Parsons* and *Paragon Jewel Coal Co.* hold that the lessee is nothing more than a contractor who cannot benefit from a rise in the market. His interest is an economic advantage rather than an economic interest in minerals in place.

But contrary to the reasoning of the Court of Claims in the instant cases, the lessee subject to termination on short notice is in an equally tenuous position vis-a-vis the minerals in place. Although he has a potential right to benefit from a rise in the market, that right is illusory for if the market rises above the lessor's royalty, the lessor can always exercise his right to terminate the lease on short notice, and either enter into a more profitable lease or extract the mineral himself and sell it. The terminabil-

ity on short notice provision therefore gives the lessor the unilateral right to assume complete and unfettered dominion over the mineral deposit. "Such right on the part of the lessor to terminate would appear to be fatal to a lessee's ability to claim the depletion deduction because no right to extract until exhaustion of the coal has been granted." *Whitmer* v. *Commissioner*, 443 F.2d 170, 173 (3d Cir. 1971).

2. There is, moreover, no basis for the Court of Claim's conclusion that if respondents are not entitled to the depletion deduction, "there will be no depletion on the coal mined under these leases" (Pet. App. 9a). The court apparently believed this conclusion to follow from the fact that under Section 631(c) of the 1954 Code, the lessors receive capital gains treatment on the royalties received. But the capital gains treatment to which the lessors would be entitled under Section 631(c) does not deprive them of the benefits of depletion. To the contrary, its applicability insures the lessors' eligibility for depletion. The special capital gains rule of Section 631(c) applies only when the "owner retains an economic interest in such coal * * *." In these circumstances, the owner fully recoups his capital investment in the minerals and thereby obtains the benefits of depletion under the cost depletion method (Section 612) by measuring his gain by "the difference between the amount realized from the disposal of such coal * * * and the adjusted depletion basis thereof." Accordingly, it is the lessors and not respondent-lessees who are entitled to the depletion deductions at issue here.

ARGUMENT

A MINERAL LESSEE HAS NO INTEREST IN THE MINERALS IN PLACE AND IS THEREFORE NOT ELIGIBLE FOR THE DEPLETION DEDUCTION IF THE LESSOR CAN TERMINATE THE LEASE ON 30 DAYS' NOTICE WITHOUT CAUSE

A. Qualification for the Depletion Deduction Requires a Capital Investment in the Minerals in Place

Section 611(a) of the Internal Revenue Code of 1954 (Appendix, *infra*, 1a) provides that "[i]n the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion * * * according to the peculiar conditions in each case * * *."[6] As this Court has declared on several occasions, the depletion allowance "is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production." *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366 (1938), quoted in *Parsons* v. *Smith*, 359 U.S. 215, 220 (1959). Thus, the deduction is "designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capi-

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[6] Pursuant to Treasury Regulations on Income Tax, Section 1.611-1(a)(1) (26 C.F.R.) (Appendix, *infra*, 1a-2a), a taxpayer is authorized to calculate his depletion deduction on the basis of his cost (Section 612) or on the basis of a specified percentage of the gross income from the property (Section 613), whichever results in the greater allowance for any taxable year. Section 613(b)(4) of the Code provides that taxpayers may claim percentage depletion deductions with respect to coal equal to 10% of the "gross income from the property." Such depletion deductions may, in no event, exceed 50% of "the taxpayer's taxable income from the property (computed without allowance for depletion)." Section 613(a) of the Code.

tal is unimpaired." *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 312 (1956). "In short, the purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset." *Parsons* v. *Smith*, *supra*, 359 U.S. at 220. Accord: *Paragon Jewel Coal Co.* v. *Commissioner*, 380 U.S. 624, 631 (1965); *Anderson* v. *Helvering*, 310 U.S. 404, 408 (1940); *Kirby Petroleum Co.* v. *Commissioner*, 326 U.S. 599, 603 (1946).

From its very inception in the Revenue Act of 1918, qualification for the depletion deduction has required a capital investment in the minerals in place. Although the theory underlying the deduction is to permit a tax-free restoration of the owner's investment in a wasting asset, the statute has generally accorded the owner much more than a recovery of his actual out-of-pocket investment in the minerals in place. For example, under the Revenue Act of 1918 the "capital" that such an owner was permitted to recover by depletion was not limited to his own investment in the minerals in place but rather was the "fair market value of the property at the date" that the mineral deposits were "discovered."[7] See Revenue Act of 1918, ch. 18, Sections 214(a)(10), 234(a)(9), 40 Stat. 1068, 1078. As a result, depletion at the outset was computed by reference to an "investment" that was "stepped up" from the owner's actual capitalized outlays.[8]

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[7] The 1918 Act further provided that the depletion allowance with respect to mineral deposits discovered prior to March 1, 1913, should be computed on the basis of the property's fair market value as of that date (the date the Sixteenth Amendment to the Constitution, permitting imposition of an income tax, was ratified). See Section 214(a)(10) of the Revenue Act of 1918, ch. 18, 40 Stat. 1068.

[8] This method of computing allowable depletion deductions was apparently designed to foster three principal goals: "to encourage the discovery and development of new resources; to provide some measure

The computation of depletion allowances on the basis of "discovery" values proved impracticable and was soon replaced by the more administrable percentage depletion methods that have, in large measure, survived to the present statute. See Revenue Act of 1926, ch. 27, Section 204(c), 44 Stat. 9. But this change in the method of calculating depletion deductions did not represent a shift in the theory underlying the depletion allowance. To the contrary, the change was designed only to render the computation of those allowances more certain. As this Court recognized in *Helvering* v. *Bankline Oil Co.*, *supra*, 303 U.S. at 366–367 (emphasis supplied):

> In order to determine whether respondent is entitled to depletion with respect to the production in question, we must recur to the fundamental purposes of the statutory allowance. The deduction is permitted as an act of grace. It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production. *United States* v. *Ludey*, 274 U.S. 295, 302. *The granting of an arbitrary deduction, in the case of oil and gas wells, of a percentage of gross income was in the interest of convenience and in no way altered the fundamental theory of the allowance.*

See also *Usibelli* v. *Commissioner*, 229 F.2d 539 (9th Cir. 1955). Qualification for the depletion deduction thus continues to require that the claiming party possess an interest in the entire mineral deposit.[9]

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of equality between producers whose discoveries were [made] afterward; and to 'equalize' the tax treatment of those who operated their own discoveries and those who purchased proven areas." Sneed, "*The Economic Interest*," 35 Tex. L. Rev. 314 (1957), and authorities cited therein.

[9] For example, every taxpayer claiming a depletion of allowance is required to make a cost depletion calculation. *Producers Oil Corp.* v. *Commissioner*, 43 B.T.A. 9 (1940). He must estimate the total mineral reserves and determine the percentage of mineral reserves removed

The decisions of this Court involving eligibility for the depletion allowance uniformly require that the taxpayer establish the equivalent of an ownership interest in the minerals in place. In response to the variety of financial arrangements employed in the extraction of minerals, this Court almost 50 years ago in *Palmer* v. *Bender*, 287 U.S. 551 (1933), developed the "economic interest" test for determining what interests in mineral deposits were permitted a depletion deduction under the practically identical statutory predecessors of Sections 611 and 613. As the Court there stated (287 U.S. at 557), "[t]he language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital." The Court further said that the depletion deduction is not "dependent upon the particular legal form of the taxpayer's interest in the property to be depleted, [and that] [it] is enough if * * * he has an *economic interest* in the oil, in place, which is depleted by production" (287 U.S. at 557; emphasis added). Accord: Treasury Regulations on Income Tax, Section 1.611-1(b)(1) (26 C.F.R.), Appendix, *infra*, 2a.

Thus, in *Palmer* v. *Bender*, *supra*, the Court upheld a depletion deduction claimed by lessees who acquired complete legal control of the oil in place and subsequently transferred their operating interests to a third party in

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and sold during the taxable year in order to calculate the amount of cost depletion deductions allowable for that year. The taxpayer's cost is then divided by his estimated reserves in the mineral and multiplied by the number of units of such mineral sold in the taxable year. See Treasury Regulations on Income Tax, Section 1.611-2(a) (26 C.F.R.). This calculation rests upon the understanding that in calculating his depletable interest, the taxpayer must look to the entire mineral interest.

exchange for a royalty or bonus from oil to be produced. In so ruling, the Court rejected the argument that the transactions were outright sales of the leases for the stipulated consideration of bonus paid and royalties to be received so that the only deduction allowable to the lessees was their cost of the properties. As the Court analyzed the arrangements, "[W]hen the two lessees transferred their operating rights to the two oil companies, whether they became technical sublessors or not, they retained, by their stipulations for royalties, an economic interest in the oil in place, identical with that of a lessor" (287 U.S. at 558).

Subsequently, in *Helvering* v. *Bankline Oil Co.*, *supra*, 303 U.S. at 367, the Court elaborated on the "economic interest" concept. It observed that "* * * the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit." See Treasury Regulations, Section 1.611-1(b)(1), Appendix, *infra*, 2a. Applying this principle to the facts of that case, the Court held that a processor who acquired the right to take wet gas from the wellheads and to extract and sell gasoline therefrom, paying the owners a percentage of the proceeds of such sales, had acquired an economic advantage, but not an economic interest in the gas in place even though the processor's profits in some instances were determined solely by reference to the sales price of the gasoline and the natural gas.

The foregoing authorities therefore establish beyond question that eligibility for the depletion deduction requires much more than simply the receipt of income derived from the extraction or sale of minerals. If the rule were otherwise, an oil drill operator, a public utility selling natural gas to customers, or the owner of a gasoline

service station could claim the deduction. But such is not the case. The relationship of such persons to the particular minerals is one of economic advantage, *viz.*, the opportunity to perform services in the extraction process or to sell minerals at a profit. However, the depletion deduction is premised on the theory that it affords a tax-free recovery of the impairment of capital resulting from exhaustion of the mineral deposit. Hence, the claimant to the deduction must have a capital investment in the minerals in place which diminishes in value as a consequence of the extraction process.

We submit that a mineral lessee has no capital investment in the minerals in place and is therefore not eligible for the depletion deduction if the lessor can terminate the lease on 30 days' notice without cause. In such circumstances, the lessee is a mere tenant at will whose interest is entirely subject to the whim of the lessor who can force him to abandon the venture on short notice. How can it be said that the lessee has a capital investment in the minerals in place if his right to extract the minerals is subject to a contingency totally beyond his control?

It is therefore hardly surprising that two decisions of this Court employing the economic interest test have emphasized that a lessor's unqualified right to terminate a lease on short notice without cause deprives the lessee of any capital investment in the minerals in place that would support a claimed depletion deduction. *Parsons* v. *Smith*, 359 U.S. 215 (1959); *Paragon Jewel Coal Co.* v. *Commissioner*, 380 U.S. 624 (1965). The Court's analysis in these cases confirms the correctness of the proposition that a mineral lessee cannot claim the depletion deduction if the lessor can terminate the lease on short notice without cause. We therefore turn to a detailed discussion of both *Parsons* and *Paragon Jewel Coal Co.* to show why their

reasoning is fully applicable here and requires reversal of the decision below.

B. A Mineral Lessee Does Not Have a Depletable Capital Investment in Minerals in Place if the Lessor can Terminate the Lease on Short Notice Without Cause

1. In *Parsons* v. *Smith*, 359 U.S. 215 (1959), this Court affirmed two decisions of the Third Circuit (255 F.2d 595 (1958); *id.* at 597) disallowing mineral lessees' claimed depletion deductions where "the contracts were completely terminable without cause on short notice" (359 U.S. at 225). There, the taxpayers had leased coal-bearing land; they agreed to strip mine the tract, and to deliver the coal to the lessors in exchange for a fixed tonnage price. Both lessees provided the labor and equipment which involved substantial cash outlays. In ruling that the lessees did not qualify for the depletion deduction, the Court rejected their argument that "by their contracts to mine the coal, and particularly by contributing their equipment, organizations and skills to the mining project as required by those contracts, they, in legal effect, made a capital investment in, and thereby acquired an economic interest in, the coal in place * * *" (*id.* at 223-224). As the Court saw the matter, "[b]y their contracts, which were completely terminable without cause on short notice, [the lessees] simply agreed to provide the equipment and do the work required to strip mine coal from designated lands of the landowners and to deliver the coal to the latter * * * [for] a fixed sum per ton" (*id.* at 224).

In *Paragon Jewel Coal Co.* v. *Commissioner*, *supra*, the Court likewise reaffirmed that mineral lessees whose interests under the lease are subject to termination on short notice without cause did not have a depletable capi-

tal investment in the minerals in place. There, a number of contractors had agreed with Paragon, which had leased certain coal properties, to extract coal by the drift mining method at their own expense and to deliver it to Paragon for a fixed price per ton. Although the contracts were silent with respect to termination and were apparently to run for an indefinite period, the contractors were under no obligation to mine a specific amount of coal and were not given the right to mine any particular area to exhaustion. In fact, many of the contractors quit mining when it suited them.

Although the leases in *Paragon Jewel Coal Co.* did not specifically empower the lessor to terminate on short notice, the Court found that as a practical matter the lessor had such a right. The Court premised its construction of the lease on the facts that " 'the contracts did not fix upon the operators an *obligation* to mine to exhaustion' " and that "many of them quit at any time they chose" (380 U.S. at 634; emphasis in original). Given the right to terminate on the part of the contractors, the Court found a corresponding right on the part of the lessor. As the Court observed, "[W]e are unable to say that it is any more inequitable to allow Paragon to terminate the contracts at will than it is to allow the contractors to terminate work and thereby impose upon Paragon the obligation to get other people to work the mine or forfeit its right under the leases" (*ibid.*).

To be sure, the decision in *Paragon Jewel Coal Co.* did not turn on the basis of the Court's construction of the lease as containing a right to terminate on the part of the lessor. Rather, the Court ultimately concluded that the contractors had no depletable capital investment in the coal in place because Paragon was bound to pay a fixed price for the coal regardless of the market conditions at

the time of delivery. In these circumstances, the contractors has no depletable economic interest in the coal in place because they "did not look to the sale of the coal for a return of their investment, but looked solely to Paragon to abide by its covenant" (380 U.S. at 635).

But the fact that the lessees in *Parsons* and *Paragon Jewel Coal Co.* agreed to deliver the coal for a fixed price does not diminish the significance of the lessor's right to terminate on short notice. The ultimate question to be addressed in these cases is which party has a capital investment in the minerals in place. Thus, the fact that in the instant cases, respondents had the right to sell the coal at any price the market would bear does not automatically establish that they had a depletable capital investment in the coal in place as opposed to a more economic advantage akin to that of a wholesaler or distributor. As this Court observed in *Helvering* v. *Bankline Oil Co.*, *supra*, 303 U.S. at 368, "[W]hether or not the wet gas had a market value and, if it had, whether that value was greater than the amount respondent paid, is in no sense determinative. Respondent was still a processor, paying for what it received at the well's mouth."

Given the lessors' right to terminate the leases on 30 days' notice, without cause, it is difficult to imagine what kind of "economic interest" respondents could be said to have acquired in the minerals in place. Respondents' right to mine the coal was completely subject to the will of their lessors who could have forced them to abandon their ventures on short notice if the lessors found the leases to be unprofitable or disadvantageous in light of changing market conditions. In these circumstances, it is the lessors who have the economic interest in the coal in place and respondents cannot claim a right to exhaust either the entire coal deposits or any particular substantial part of it.

In short, the lessor's right to terminate on short notice without cause is simply another factor that deprives the lessee of a depletable capital investment in the minerals in place in the same fashion as the lessee's obligation to deliver the minerals to the lessor at a fixed price. In the latter case, *Parsons* and *Paragon Jewel Coal Co.* hold that the lessee is nothing more than a contractor who cannot benefit from a rise in the market. His interest is an economic advantage rather than an economic interest in minerals in place.

But contrary to the reasoning of the Court of Claims in the instant cases, the lessee subject to termination on short notice is in an equally tenuous position vis-a-vis the minerals in place. Although he has a potential right to benefit from a rise in the market, that right is illusory for practical economics will compel the lessor to terminate the lease and conclude a more favorable arrangement if market conditions so dictate. As the Third Circuit observed in *Whitmer* v. *Commissioner*, 443 F.2d 170, 173 (1971), "[s]uch right on the part of the lessor to terminate would appear to be fatal to a lessee's ability to claim the depletion deduction because no right to extract until exhaustion of the coal has been granted." Accord: *Costantino* v. *Commissioner*, 445 F.2d 405, 409 (3d Cir. 1971) (30-day termination); *Mullins* v. *Commissioner*, 48 T.C. 571 (1967) (60-day termination); *Winters Coal Co.* v. *Commissioner*, 57 T.C. 249 (1971) (30 and 60-day termination), rev'd on other grounds, 496 F.2d 995 (5th Cir. 1974); *Holbrook* v. *Commissioner*, 65 T.C. 415 (1975) (30-day termination); *Weaver* v. *Commissioner*, 72 T.C. 594, 606-609 (1979) (immediate termination); G.C.M. 26290, 1950-1 Cum. Bull. 42, declared obsolete, Rev. Rul. 70-277, 1970-1 Cum. Bull. 280.

2. In light of the foregoing, we submit that the decision of the Court of Claims in the instant cases and in *Baker-*

town Coal Co. v. *United States*, 485 F.2d 633, 640-641 (1973), to which it adhered (Pet. App. 5a), reflects a fundamental misconception of this Court's "economic interest" test. In *Bakertown Coal Co.*, the Court of Claims acknowledged that this Court in *Parsons* v. *Smith*, *supra*, accorded significant weight to the lessor's right to terminate on short notice without cause in ruling that the lessee was thereby deprived of an economic interest in the minerals in place. However, the Court of Claims refused to ascribe controlling weight to the lessor's right to terminate at will. In its view, "[t]hough terminability was one of the seven disqualifying factors mentioned [in *Parsons* v. *Smith*, *supra*], it cannot be considered either in isolation or in the abstract, as the Government would have it" (485 F.2d at 639). The Court of Claims concluded that "the matter of terminability becomes only a colorably relevant factor where the applicant for the allowance lacks the traditional qualifications for depletion, as reflected by the other six conditions referenced by the court" (*ibid.*).[10] The

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[10] In *Parsons* v. *Smith*, *supra*, 359 U.S. at 215, the Court enumerated seven factors in support of its decision rejecting mining contractors' claims to depletion deductions, as follows (*id.* at 225; emphasis supplied):

> (1) that petitioners' investments were in their equipment, all of which was movable—not in the coal in place; (2) that their investments in equipment were recoverable through depreciation—not depletion; (3) *that the contracts were completely terminable without cause on short notice;* (4) that the landowners did not agree to surrender and did not actually surrender to petitioners any capital interest in the coal in place; (5) that the coal at all times, even after it was mined, belonged entirely to the landowners, and that petitioners could not sell or keep any of it but were required to deliver all that they mined to the landowners; (6) that petitioners were not to have any part of the proceeds of the sale of the coal, but, on the contrary, they were to be paid a fixed sum for each ton mined and delivered, which was, as stated in *Huss*, agreed to be in "full compensation for the full performance of all work and for the furnishing of all

Court of Claims therefore distinguished *Parsons* v. *Smith*, *supra*, on the ground that there "the coal company was bound to pay the contractors the posted fee regardless of the condition of the market at the time of delivery and, thus, that the contractors did not look to the sale of the coal for a return of their investment but looked solely to the coal company" (485 F.2d at 640).

To be sure, the Court of Claims correctly concluded that the mining contractors in *Parsons* v. *Smith*, *supra*, "were equally deficient under each of the six other criteria set forth by the Supreme Court" (485 F.2d at 639). See also *Paragon Jewel Coal Co.* v. *Commissioner*, *supra*; *United States* v. *Stallard*, 273 F.2d 847 (4th Cir. 1959); *McCall* v. *Commissioner*, 312 F.2d 699 (4th Cir. 1963). But this purported distinction, upon which respondents rely as well (Br. in Opp. 16), ignores this Court's admonition, made in the context of another depletion case, that "the tax law deals in economic realities, not legal abstractions." *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 315 (1956). As we have pointed out (*supra*, page 19), if the market price of the minerals rises above the lessor's royalty, the lessor will assuredly exercise his right to terminate the lease on short notice and will either enter into a more profitable lease or extract the mineral himself and sell it. In these circumstances, the lease provision permitting termination on short notice[11] gives the lessor the uni-

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[labor] and equipment required for the work"; and (7) that petitioners, thus, agreed to look only to the landowners for all sums to become due them under their contracts.

[11] The Court of Claims also held that, even if the lessor's right to terminate the lease were determinative, the court could not say, in the absence of proof, that 30 days was too short a period for the lessee to extract a substantial amount of coal (Pet. App. 8a). But these refund suits are analogous to an action for money had and received. Hence, respondents bore the burden of proof that they overpaid their taxes and were entitled to a refund of a particular amount. *Lewis* v.

lateral right to assume complete and unfettered dominion over the mineral deposit, *viz.*, an economic interest in the minerals in place. The unexercised termination clause therefore has profound economic significance, rather than, as the decision below erroneously concluded (Pet. App. 5a), "mere existence."[12] Accord: *United States* v. *Stallard*, 273 F.2d 847 (4th Cir. 1959); *McCall* v. *Commissioner*, 312 F.2d 699 (4th Cir. 1963); *United States* v. *Wade*, 381 F.2d 345 (5th Cir. 1967). See also *Ramey* v. *Commissioner*, 47 T.C. 363, 375 (1967), aff'd, 398 F.2d 478 (6th Cir. 1968); *Usibelli* v. *Commissioner*, 229 F.2d 539 (9th Cir. 1955); *Rissler & McMurry Co.*, 480 F.2d 684 (10th Cir. 1973).

3. Finally, there is no basis for the Court of Claims' observation, made both in the instant case (Pet. App. 9a) and in *Bakertown Coal Co.* v. *United States*, *supra*, 485 F.2d at 642, which respondents invoke as well (Br. in Opp. 20–22), that if respondents are not entitled to the depletion deduction, "there will be no depletion on the coal mined under these leases" (Pet. App. 9a). The court apparently believed this conclusion to follow from the fact that "[u]nder the express terms of Section 631(c) of the 1954 Code, the lessors are 'relegated to capital gains treatment of the royalties received,' *Paragon Jewel Coal*

Reynolds, 284 U.S. 281 (1932). The absence of proof should therefore redound to respondents' detriment, and not to the government's. At all events, the question is not whether respondents could extract a substantial amount of coal in 30 days, but whether they could extract a substantial portion of the deposits in that period. See G.C.M. 26290, *supra*.

[12] This Court's emphasis in *Parsons* v. *Smith*, *supra*, upon the lessor's right to terminate on short notice without cause is at sharp variance with the view of the dissenting judge in the court of appeals in that case (upon that court's denial of rehearing en banc) that the "right of termination does not affect a stripper's right to depletion where the requisite economic interest as defined by the Supreme Court exists" (*Huss* v. *Smith*, 255 F.2d 599, 602 (3d Cir. 1958)).

Co. v. *Commissioner, supra*, 380 U.S. at 636 * * *" (485 F.2d at 642).

But the capital gains treatment to which the lessors would be entitled under Section 631(c) does not deprive them of the benefits of depletion, which "is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." *Commissioner* v. *Southwest Exploration Co., supra*, 350 U.S. at 312. The special capital gains rule of Section 631(c) applies only when the "owner retains an economic interest in such coal * * *." In these circumstances, the owner fully recoups his capital investment in the minerals and thereby obtains the benefits of depletion by measuring his gain by "the difference between the amount realized from the disposal of such coal * * * and the adjusted depletion basis thereof * * *." While the lessor will not ratably recover his basis through percentage depletion, the subtraction of his adjusted depletion basis in measuring his gain insures that he will "make a tax-free recovery of that depleting capital asset" (*Parsons* v. *Smith, supra*, 359 U.S. at 220) under the cost depletion method (Section 612). See *Herring* v. *Commissioner*, 293 U.S. 322, 327-328 (1934).[13] Accordingly, the lessor's right to terminate on short notice without cause requires the conclusion that the lessors, and not respondents-lessees, have the requisite economic interest in the coal in place and are therefore entitled to the depletion deductions at issue here.

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[13] In these circumstances, the lessor can claim both cost depletion and capital gains treatment under Section 631(c). Where Section 631(c) is inapplicable, the lessor can claim percentage depletion but must report his receipts as ordinary income. *Burnet* v. *Harmel*, 287 U.S. 103 (1932).

CONCLUSION

For the reasons stated, the judgments of the Court of Claims should be reversed.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 611. Allowance of deduction for depletion

(a) *General Rule*—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary. * * *

* * * * *

SEC. 613. Percentage depletion

(a) *General Rule*—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). * * * In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

* * * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.611-1. Allowance of deduction for depletion.

(a) *Depletion of mines, oil and gas wells, other natural deposits, and timber*—(1) *In general.* Section 611 provides that there shall be allowed as a deduction in computing taxable income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion. * * * In the case of other exhaustible natural resources the allowance

for depletion shall be computed upon either the adjusted depletion basis of the property (see section 612, relating to cost depletion) or upon a percentage of gross income from the property (see section 613, relating to percentage depletion), whichever results in the greater allowance for depletion for any taxable year. In no case will depletion based upon discovery value be allowed.

* * * * *

(b) *Economic interest.* (1) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the extraction of the mineral or severance of the timber, to which he must look for a return of his capital. For an exception in the case of certain mineral production payments, see section 636 and the regulations thereunder. A person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because through a contractual relation he possesses a mere economic or pecuniary advantage derived from production. For example, an agreement between the owner of an economic interest and another entitling the latter to purchase or process the product upon production or entitling the latter to compensation for extraction or cutting does not convey a depletable economic interest. Further, depletion deductions with respect to an economic interest of a corporation are allowed to the corporation and not to its shareholders.

* * * * *

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1980

UNITED STATES OF AMERICA,
Petitioner,

v.

ELWOOD SWANK and RITA SWANK,

UNITED STATES OF AMERICA,
Petitioner,

v.

BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA,
Petitioner,

v.

BULL RUN MINING CO., INC.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF CLAIMS

BRIEF FOR RESPONDENT BLACK HAWK COAL CORPORATION, INC.

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QUESTION PRESENTED

Whether a provision in a coal mining lease permitting both parties thereto to terminate the lease on 30 days' notice without any grounds assigned deprives the lessee of an economic interest in the coal in place so that the lessee is not entitled to a depletion deduction under Sections 611(a) and 613 of the Internal Revenue Code of 1954, where the termination clause was never invoked or exercised by either party in the 13-year period during which the lessee mined the coal to exhaustion.

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BRIEF FOR RESPONDENT BLACK HAWK COAL CORPORATION, INC.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth at U.S. Br. 1a-2a, in the text below at 12, 13, 30, and 44, n.4, and in the Appendix below at pp. 1a-7a.

STATEMENT

In the second of this trio of cases, involving respondent Black Hawk Coal Corporation, Inc., hereinafter simply "Black Hawk," the facts stipulated by the parties (J.A. 68a-73a) were adopted by the Court of Claims as its own findings of fact (Pet. 4a, note 2).

Black Hawk became lessee of the coal lands in question in 1964 (J.A. 69a, ¶ 3; for the text of the lease, see J.A. 73a-86a). "All coal feasible to mine has been extracted with mining operations ceasing in 1976" (J.A. 71a, ¶ 8). The tax years here involved are 1970 through 1972 (J.A. 69a, ¶ 2; *id.* 71a-72a, ¶¶ 12-13).

Black Hawk paid its lessor a lump sum or a royalty, whichever was greater (J.A. 77a-79a, ¶¶ 1-3), and also paid all taxes on the real estate, on the coal, and on its plant (J.A. 79a, ¶ 5). Black Hawk was free to sell its coal to anyone, and in fact never sold any of it either to its lessor or to the latter's sales agent (J.A. 70a-71a, ¶ 8).

The lease contained provisions for forfeiture for non-payment of rent (J.A. 80a, ¶ 7) and for insolvency (J.A. 84a-85a, ¶ 14), and also contained the following cancellation provision (J.A. 85a):

> 15th. This agreement of lease may be cancelled by either party hereto at any time by either party giving to the other thirty (30) days written notice of its or his intention to cancel same. Such notices shall be sufficient if given by registered letter postmarked in the United States mails, and thirty (30) days after receipt of such letter said agreement of lease shall stand cancelled and terminated, and shall be of no further force and effect.

In actual fact, the foregoing cancellation provision was never invoked by either party to the lease during the 13-year period in which the tract that it covered was mined to exhaustion (J.A. 69a, ¶ 4; *id.* 71a, ¶ 8).

All of the actual mining under the lease was done by independent contractors (J.A. 70a, ¶ 6).

None of those independent contractors made any claim for percentage depletion. Black Hawk's lessor made no claim for percentage depletion. Black Hawk is the sole claimant to a deduction for percentage depletion. (J.A. 71a, ¶ 10.)

Black Hawk's claim for a depletion deduction was denied by the Commissioner for the tax years in question; deficiencies were assessed and paid; claims for refund were then denied; and suit to recover the deficiencies paid was thereupon brought in the Court of Claims. (J.A. 71a-72a, ¶¶ 11-15.)

By stipulation, the only issue in the case is whether the presence of the cancellation clause in the lease precluded Black Hawk's entitlement to the claimed depletion deduction, an issue identical to that which the Court of Claims had decided in the lessee's favor under similar leases in the earlier case of *Bakertown Coal Co., Inc. v. United States,* 485 F.2d 633 (J.A. 72a, ¶¶ 16-18).

The Court of Claims followed that decision here. It held that Black Hawk under its lease had acquired an economic interest in the coal in place, and thus was entitled to a deduction for depletion; that the unexercised 30-day cancellation clause did not require a different result; and, pointing out that if Black Hawk could not deduct for depletion, no one could, entered judgment in Black Hawk's favor (Pet. 1a-16a; *id.* 19a-20a; 602 F.2d 348).

Because of conflict with the Third Circuit's ruling in *Whitmer v. C.I.R.*, 443 F.2d 170, this Court granted certiorari.

SUMMARY OF ARGUMENT

1. The purpose of the deduction for depletion, which has been in the income tax law since 1913, is to afford compensation to the owner for the reduction of a wasting asset. And even before equitable division of that deduction in the case of leases had been specifically provided by statute, a lessee of mineral lands was allowed to subtract a reasonable portion of the depletion deduction in respect of his property interest in the land. *Lynch v. Alworth-Stephens Co.*, 267 U.S. 364.

2. After Congress settled the depletion allowance on a percentage basis, and oil and gas interests came to be fractionalized, this Court declared that entitlement to the depletion deduction depended on whether the taxpayer had acquired, by investment, an economic interest in the mineral in place, to which he was required to look for return of his capital. *Palmer v. Bender*, 287 U.S. 551. But ownership was essential. *Thomas v. Perkins*, 301 U.S. 655. Accordingly, when it was shown that a taxpayer had no capital investment in the mineral in the ground, it was held that he had no economic interest but only an economic advantage, and thus could not deduct for depletion. *Helvering v. Bankline Oil Co.*, 303 U.S. 362. The distinction thus drawn was carried virtually verbatim into a Treasury Regulation that is still in force, in which down to this very day there is not the slightest suggestion that an economic interest in the mineral in place vanishes simply because a cancellation clause was included in the instrument conveying that interest.

3. When contract coal miners undertook to claim a share in the depletion allowance, they were sustained by some courts, primarily by the Fourth Circuit, which distorted the concept of economic interest laid down here—by omitting the vital qualification, "in the mineral in place," and thus erroneously permitting depletion simply for investment "in the enterprise." Thereafter, when another circuit disagreed, this Court resolved the depletion issue against the contract coal miner, showing that he had never acquired any economic interest in the mineral in place. *Parsons v. Smith,* 359 U.S. 215.

The Fourth Circuit, however, refused to be convinced, and, by concentrating on particular incidents of the contract miners' arrangements, notably with respect to terminability and to a right to mine to exhaustion, in effect refused to follow *Parsons v. Smith.* It took this Court's resounding reversal of that recalcitrant tribunal in *Paragon Coal Co. v. Commissioner,* 380 U.S. 624, to establish the immateriality of both of those incidents, and to end for all time the claims of mere contract miners to share in the statutory depletion allowance.

4. Under the Internal Revenue Code, the Treasury Regulations, and the decisions of this Court, Black Hawk, which under its lease mined its tract of coal to exhaustion over a 13-year period, plainly acquired an economic interest in the coal in place, and thus is entitled to deduct for the depletion of that now completely wasted asset. And nothing in that Code, or in those Regulations, or in any decision here even intimates that a different result should follow simply because its lease contained a mutual termination clause that neither party thereto ever invoked or exercised over all of those years.

Contentions to the contrary, based on expressions as to the significance of terminability clauses—expressions that are taken from inapplicable and now wholly discredited contract miner cases—terminability clauses are simply irrelevant in the present lease situation. That is because the lessee here plainly had precisely what the contract miner never did, namely, the requisite economic interest in the coal in place.

Inasmuch as Black Hawk as lessee obviously qualifies for the depletion deduction in respect of all the tax years involved in this case, the unexercised termination clause in its lease is a matter of abstraction rather than of reality; and this is particularly true because the earliest depletion decisions by this Court always focused on the situation that existed during the tax years being litigated. It is significant that, in the present case, Black Hawk continued to mine coal for four years subsequent to the tax years presently in question, and that it only ceased when there was no more coal to mine.

It is enough that, as the Court of Claims said, Black Hawk at the very least could mine for 30 days; such a period is not too short. As a practical matter, no lessee would ever agree to less. And, since "the tax law deals in economic realities, not legal abstractions" (*Commissioner v. Southwest Exploration Co.*, 350 U.S. 308, 315), there is no need to examine whatever hypothetical possibilities might be conjured up by imaginative if unrealistic minds. Moreover, there is surely neither statutory nor decisional support for the Tax Court's grotesque rule that, while an unexercised 120-day cancellation clause does not defeat a lessee's right to deduct for depletion, similarly unexercised clauses providing for cancellation on 60-day or 30-day notice do.

The confusion engendered in the contract coal miner cases over ten years of unedifying litigating struggle, cases that mostly rested on disregard of principle with concurrent emphasis on mere contractual incidents, should warn against acceptance of the contentions now advanced by the Government. Those arguments similarly ignore the now settled law of entitlement to depletion, and similarly concentrate on the gossamer of a purely theoretical right to cancel the lease, a right never exercised here either in any of the cognizant tax years—or afterwards.

5. Equitable apportionment of the depletion allowance in the case of leases ceased to be applicable to coal lands in 1951; in that year Congress gave coal lessors capital gains treatment for their royalties, in lieu of any share in the deduction for depletion. That new departure in respect of coal leases is now § 631(c), I.R.C. 1954 (App. 2a-3a). Accordingly, as the Court of Claims twice pointed out, here as well as in the predecessor *Bakertown* case, only the lessees involved could qualify for percentage depletion. Therefore, said that court, if the lessees were denied the depletion deduction, the result would be that, although the entire leased coal tract had been mined to exhaustion, no depletion allowance would inure to anyone: The lessor is now barred by § 631(c), the contract miners by this Court's decisions in *Parsons* and *Paragon Coal.* If therefore the lessee were also barred, depletion would be wholly unavailable to any party in respect of a tract now wholly denuded of minerals. That result would completely frustrate the repeatedly enacted intent of Congress to provide appropriate compensation for the owner of a wasting asset that is used up in the course of producing income.

The Government, however, contends that "the capital gains treatment to which the lessors would be entitled under Section 631(c) does not deprive them of the benefits of depletion" (U.S. Br. 9, 23). But that argument is wholly untenable; it completely ignores the portion of Section 631(c) which expressly states, "Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal." *See also* Treas. Reg. §§ 1.611-1(b)(2) and 1.631-3(b)(1), p. 44, n. 4, below, and App. 5a.

ARGUMENT

The controlling fact in this case is that Black Hawk, a lessee of coal lands, mined those lands throughout the tax years involved and ultimately mined its property to exhaustion over a 13-year period. Its lease contained a provision permitting both parties thereto to terminate the relationship on 30 days' notice, without any grounds assigned. But that provision was never invoked or exercised by either lessor or lessee during any of the tax years now in litigation, or during all of the 13 years in which coal could be extracted.

The Court of Claims accordingly held that, in those circumstances, Black Hawk had acquired a sufficient economic interest in the coal in place to entitle it to a percentage depletion deduction under §§ 611(a) and 613 of the Internal Revenue Code of 1954. Indeed, said the Court of Claims, if Black Hawk were denied such a deduction, then the entire coal deposits comprised within its lease would have been exhausted without allowance of percentage depletion to any party, inasmuch as all lessors of coal lands had since 1951 been granted capital gains treatment of their lease royalties, and in

return had been expressly deprived by Congress of any allowance for percentage depletion.

The Government's contentions to the contrary, as well as rulings by the Third Circuit and the Tax Court in conflict with the Court of Claims, not only distort this Court's governing determinations, but fly in the face of the clear provisions of § 631(c), I.R.C. For those rulings rest on the flimsy abstraction of a cancellation clause that was never invoked or exercised over the 13-year period during which coal remained to be mined, and thus deny the reality of the economic interest in the coal in place that Black Hawk acquired by investment and then mined to exhaustion.

We think that we can best assist the Court in this matter by dispassionately narrating in detached fashion the course of the law of mineral depletion as it has been developed by legislation, by Treasury Regulations, and by decisions here. And, by laying bare the confusion found in the earlier case law dealing with the claims of contract coal miners who sought to share in that allowance, confusion that was a consequence of concentration on particular incidents rather than on economic realities, we think that we can help the Court avoid similar pitfalls now, pitfalls that would surely follow were the Government's present arguments pemitted to prevail.

I.

THE PURPOSE OF THE DEPLETION ALLOWANCE FOR MINERALS IS TO COMPENSATE THE OWNERS OF WASTING CAPITAL ASSETS, AND CONGRESS HAS FOR MANY YEARS PROVIDED THAT, IN THE CASE OF LEASES, THAT ALLOWANCE IS TO BE EQUITABLY APPORTIONED BETWEEN LESSOR AND LESSEE

A. The purpose of the depletion deduction

The deduction for the depletion of mineral assets appeared in the first income tax law passed after the adoption of the Sixteenth Amendment (Sec. II B [sixth] of the Act of Oct. 3, 1913, ch. 16, 38 Stat. 114, 167), and has been part of our tax law ever since. Its purpose was stated by Mr. Justice Brandeis for the Court in *United States v. Ludey*, 274 U.S. 295, 302, in these terms:

> The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment.

A later formulation is that in *Parsons v. Smith*, 359 U.S. 215, 220:

> The purpose of the deduction for depletion is plain and has been many times declared by this Court. "It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part

used up in production." *Helvering v. Bankline Oil Co.*, 303 U.S. 362, 366. And see *United States v. Ludey*, 274 U.S. 295, 302; *Helvering v. Elbe Oil Land Development Co.*, 303 U.S. 372, 375; *Anderson v. Helvering*, 310 U.S. 404, 408; *Kirby Petroleum Co. v. Commissioner*, 326 U.S. 599, 603. "[The depletion] exclusion is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." *Commissioner v. Southwest Exploration Co.*, 350 U.S. 308, 312. Save for its application only to gross income from mineral deposits and standing timber, the purpose of "the deduction for depletion does not differ from the deduction for depreciation." *United States v. Ludey*, 274 U.S., at 303. In short, the purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset.

Later restatements will be found in *United States v. Cannelton Sewer Pipe Co.*, 364 U.S. 76, 81, 86, 88, and in *Paragon Coal Co. v. Commissioner*, 380 U.S. 624, 631. But all are to the same effect: Mineral depletion for tax purposes is an allowance for the exhaustion of capital assets.

B. Apportionment of the depletion deduction between lessor and lessee

The question whether a lessee of mineral lands was entitled to any part of the depletion allowance arose before mineral leases were ever specifically mentioned in tax legislation. In *Lynch v. Alworth-Stephens Co.*, 267 U.S. 364, which involved that question for the year 1917, the Court decided the query in the affirmative. It said (267 U.S. at 369, citations omitted):

> It is, of course, true that the leases here under review did not convey title to the unextracted ore deposits, * * * ; but is equally true that such leases, conferring upon the lessee the exclusive possession of the deposits and the valuable right of removing and reducing the ore to ownership, created a very real and substantial interest therein. * * * And there can be no doubt that such an interest is property. * * *

Accordingly, the Court held (267 U.S. at 369-70) that:

> The interest of respondent under its leases in the mines being property, its right to deduct a reasonable allowance for exhaustion of such property, if there be any, during the taxable year results from the plain terms of the statute, such deduction, since the property is an interest in mines, to be limited to the amount of the exhaustion of respondent's interest caused by the depletion of the mines during the taxable year.

Later, beginning with the Revenue Act of 1918, § 214(a)(10), ch. 18, 40 Stat. 1058, 1068, the depletion status of mineral lessees was placed on a statutory basis. Ever since then, successive Internal Revenue Acts have provided, with scarcely any change in phraseology—and here we quote from the current provision, § 611(b)(1), I.R.C. 1954—

> In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee.[1]

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[1] Earlier enactments, in addition to § 214(a)(10) of the Revenue Act of 1918, are: Revenue Act of 1921, § 214(a)(10), ch. 136, 42 Stat. 227, 241; Revenue Act of 1924, § 214(a)(9), ch. 234, 43 Stat. 253, 270-271; Revenue Act of 1926, § 214(a)(9),

[footnote continued]

Similarly, Treas. Reg. § 1.611-1(c)(2) provides:

> In the case of a lease, the deduction for depletion under section 611 shall be equitably apportioned between the lessor and lessee.

See also Treas. Reg. § 1.613-1 (App. 3a-4a).

But, as we show under Point V, pp. 43-47, below, there has been no such apportionment in the case of coal leases since 1951, for in that year Congress gave the lessor of coal lands capital gains treatment of his royalties, and in return expressly provided that such lessor would no longer be entitled to depletion. That new arrangement is, as we shall show, still in effect.

We now turn to the decisions that arose out of the separation of interests in oil and gas deposits that did not involve formal leases.

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ch. 27, 44 Stat. 9, 27; Revenue Act of 1928, § 23(*l*), ch. 852, 45 Stat. 791, 800; Revenue Act of 1932, § 23(*l*), ch. 209, 47 Stat. 169, 181; Revenue Act of 1934, § 23(m), ch. 277, 48 Stat. 680, 690; Revenue Act of 1936, § 23(m), ch. 690, 49 Stat. 1648, 1660; Revenue Act of 1938, § 23(m), ch. 289, 52 Stat. 447, 462; and Internal Revenue Code of 1939, § 23(m), 53 Stat. 1, 14.

II.

WHEN OIL AND GAS INTERESTS CAME TO BE FRACTIONALIZED, THIS COURT REFINED THE CONCEPT OF THE DEPLETION ALLOWANCE, LIMITING ITS ENTITLEMENT TO THOSE WHO HAD ACQUIRED, BY INVESTMENT, AN ECONOMIC INTEREST IN THE MINERAL IN PLACE TO WHICH THEY LOOKED FOR A RETURN OF THEIR CAPITAL; AND THAT FORMULATION WAS CARRIED INTO A TREASURY REGULATION THAT IS STILL IN FORCE

A. Statutory development of the depletion allowance

Originally, the basis for calculating the depletion allowance was the discovery value of the mineral deposit. This proved extremely difficult to administer, and so in the Internal Revenue Act of 1926 Congress substituted a system of percentage depletion, which has remained in force ever since. That statutory development is fully traced in *United States v. Dakota-Montana Oil Co.*, 288 U.S. 459, 460-61, and in *Helvering v. Twin Bell Oil Syndicate*, 293 U.S. 312, 315-18.

The present percentage depletion provision is § 613(a), I.R.C. 1954, and the present percentage allowed to coal mines, appearing in § 613(b)(4), I.R.C. 1954, is 10 per cent.

B. Decisional development of the depletion allowance

When the ownership of coal lands is divided, the relationships are not complex: lessor and lessee, with sometimes a sublessor and sublessee as well. And either the owner of the entire fee, or the owner of the coal,

or the lessee or sublessee of the coal seams, may arrange for independent contractors to do the actual mining.

But in the area of oil and gas, where more sophisticated arrangements became first a frequent and then even the usual practice, it was soon apparent that a rigid application of conventional common law estates might work injustice. Accordingly, in *Palmer v. Bender,* 287 U.S. 551, this Court held that, where the owner of an oil and gas lease transferred his lease to another in consideration of a bonus and royalties, the bonus so received was a return *pro tanto* of the transferor's capital investment in the oil, which entitled him to a depletion allowance. The Court said (287 U.S. at 558):

> In the present case the two partnerships acquired, by the leases to them, complete legal control of the oil in place. Even though legal ownership of it, in a technical sense, remained in their lessor, they, as lessees, nevertheless acquired an economic interest in it which represented their capital investment and was subject to depletion under the statute. *Lynch v. Alworth-Stephens Co., supra* [267 U.S. 364]. When the two lessees transferred their operating rights to the two oil companies, whether they became technical sublessors or not, they retained, by their stipulations for royalties, an economic interest in the oil, in place, identical with that of a lessor. *Burnet v. Harmel, supra* [287 U.S. 103]; *Bankers Pocahontas Coal Co. v. Burnet, supra* [287 U.S. 308]. Thus, throughout their changing relationships with respect to the properties, the oil in the ground was a reservoir of capital investment of the several parties, all of whom, the original lessors, the two partnerships and their transferees, were entitled to share in the oil produced.

As later explained (*Thomas v. Perkins,* 301 U.S. 655, 661; our italics):

> If Palmer had retained no interest in the oil he would have been entitled to no deduction on account of depletion. *Ownership was essential.*

Thereafter, in the leading case of *Helvering v. Bankline Oil Co.,* 303 U.S. 362, the Court after reviewing the cases denied depletion to a taxpayer who simply had a contract with the owner of gas wells to extract gasoline therefrom, on the basis that he had no investment in the gas in the ground, and, unlike Black Hawk here, "had no interest as lessor or lessee, or as sub-lessor or sub-lessee, in any of the producing wells" (303 U.S. at 366). Because of the later importance of the fundamental distinction there set forth, we must quote from Chief Justice Hughes' opinion for the Court (303 U.S. at 367, 368):

> It is true that the right to the depletion allowance does not depend upon any "particular form of legal interest in the mineral content of the land." We have said, with reference to oil wells, that it is enough if one "has an economic interest in the oil, in place, which is depleted by production"; that "the language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital." *Palmer v. Bender, supra.* But the phrase "economic interest" is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner,

by one who has no capital investment in the mineral deposit. See *Thomas v. Perkins*, 301 U.S. 655, 661.

* * *

Undoubtedly, respondent through its contracts obtained an economic advantage from the production of the gas, but that is not sufficient. The controlling fact is that respondent had no interest in the gas in place. Respondent had no capital investment in the mineral deposit which suffered depletion and is not entitled to the statutory allowance.

C. The foregoing decisional developments were carried into a Treasury Regulation that is still in force

The differentiation made in the *Bankline Oil* case, between an economic interest acquired by making a capital investment in the mineral in the ground, and a mere economic advantage arising out of a contract to extract that mineral, was copied almost verbatim into the first regulations under the Internal Revenue Code of 1939, after which there have been no major changes in the economic-interest *versus* economic-advantage paragraph. *See* Treas. Reg. 103, § 19.23(m)-1 (App. 7a); Treas. Reg. 111, § 29.23(m)-1; Treas. Reg. 118, § 39.23(m)-1(a) and (b). The regulation now in force, § 1.611-1(b)(1) of the Regulations under I.R.C. 1954, will be found at Pet. 24a-25a and at U.S. Br. 2a. It simply repeats, virtually verbatim, the *Bankline Oil* language just quoted.

It is particularly to be noted that nowhere in that regulation is there so much as a single word intimating, much less suggesting, that an economic interest in mineral

in place vanishes simply because somewhere in the instrument conveying that interest there has been inserted a cancellation clause.

D. Later oil and gas cases

Simply for the sake of completeness, we mention later oil and gas cases. Two others, decided on the same day as *Bankline Oil*, followed it, and were consistent with its teaching that mere economic advantage separated from a property interest in the oil in place was an insufficient basis for a depletion deduction. *Helvering v. O'Donnell*, 303 U.S. 370; *Helvering v. Elbe Oil Land Co.*, 303 U.S. 372.

But the decision a few years later in *Anderson v. Helvering*, 310 U.S. 404, did little to clarify matters, while two cases at the 1945 Term created little but disarray. Thus, in *Kirby Petroleum Co. v. Commissioner*, 326 U.S. 599, the Court found it necessary to "explain" no less than three earlier decisions, while in *Burton-Sutton Oil Co. v. Commissioner*, 328 U.S. 25, the prevailing opinion was occupied with extensive "explanations" of one of those earlier decisions (*Elbe Oil Land Co., supra*) that the Court had just finished "explaining" in *Kirby Petroleum* a few months earlier.

We mention the foregoing cases only because they foreshadowed the confusion that plagued the course of case law involving contract coal miners who sought to share in the depletion allowance.

III.

WHEN PERSONS WHO HAD MERELY CONTRACTED WITH OWNERS OR LESSEES OF COAL DEPOSITS SOUGHT TO SHARE IN THE STATUTORY DEPLETION ALLOWANCE, THIS COURT REJECTED THEIR CLAIMS BECAUSE SUCH CONTRACTORS HAD NO ECONOMIC INTEREST IN THE COAL IN PLACE, WHETHER OR NOT THEIR CONTRACTS WERE TERMINABLE WITHOUT ANY GROUNDS ASSIGNED, AND WHETHER OR NOT THEIR CONTRACTS ENTITLED THEM TO MINE TO EXHAUSTION

A. The Fourth Circuit distorted the guideline for entitlement to the deduction for depletion, by omitting the essential qualification that the taxpayer's economic interest must be in the coal in place

The first instance of a coal mining contractor's claim for a share in the depletion allowance reaching the Federal Reporter was *C.I.R. v. Gregory Run Coal Co.*, 212 F.2d 52 (C.A. 4), *cert. den.*, 348 U.S. 828. There the Fourth Circuit allowed such a claim on the footing that the contractors "were entitled to share in the benefits of the statute which were designed to give compensation to persons *interested in the production of a wasting asset*." We have added the italics to emphasize the extent of the Fourth Circuit's departure from the standard of "an economic interest *in the* [minerals] *in place*," again our italics, which was first formulated by this Court and then carried virtually verbatim into the Treasury Regulations (*Palmer v. Bender*, 287 U.S. 551, 558; Treas. Reg. § 1.611[b][1]).

Speaking through the same judge, the Fourth Circuit then twice repeated—and enforced—its departure from the governing standard. In *Weirton Ice & Coal Sup. Co. v.*

C.I.R., 231 F.2d 531, it allowed the mining contractor's claim to depletion on the footing that (p. 535), "No stronger proof that Weirton had in effect the right to mine the coal could be found than in its willingness to invest $500,000 *in the enterprise*." Once more, our italics, this time to stress the difference between investing "in the enterprise" and investing in the coal in place. The same notion, that a "substantial investment in the enterprise" would qualify for the right to deduct for depletion, was once more applied in *C.I.R. v. Hamill Coal Corp.*, 239 F.2d 347, 350 (C.A. 4).

Another contract coal miner who was allowed depletion by the Fourth Circuit appeared in *Stilwell v. United States*, 250 F.2d 736, where a district court ruling to the contrary (152 F. Supp. 111 [W.D. Va.]) was reversed. Interestingly enough, this was one of the Fourth Circuit's earliest decisions attributing controlling significance to the factor of terminability (250 F.2d at 739). Even more interestingly, Stilwell's mining contract was with Paragon Jewel Coal Company, whose independent litigation—it was not and could not be a party to the *Stilwell* case—resulted ultimately in the final interment of all contract coal miners' hopes of sharing in the depletion deduction (380 U.S. 624).

B. When other circuits held to the contrary, this Court resolved the depletion issue against the contract coal miner in *Parsons v. Smith*, 359 U.S. 215, for the reason that he had never acquired any economic interest in the coal in place

The first Court of Appeals to disagree with the Fourth Circuit was the Ninth, which denied a contract stripper's claim to depletion on the basis that, since such a person

had no economic interest in the coal in place, he had a mere economic advantage, which was insufficient. *Usibelli v. C.I.R.*, 229 F.2d 539.

Yet, curiously enough, the Third Circuit had, in the case just preceding *Usibelli* in the reports, held just the contrary, following the Fourth Circuit's *Gregory Run* decision in holding that the contract stripper was entitled to depletion. *C.I.R. v. Mammoth Coal Co.*, 229 F.2d 535, *cert. den.*, 352 U.S. 824.

A few years later, however, the Third Circuit had second thoughts—sounder ones, as the event proved. It held that coal miners who had only stripping contracts were mere independent contractors, and hence not entitled to depletion. While stressing the circumstances that the several contracts involved were terminable—there were two cases—it determined after reviewing all the facts that it would not follow the Fourth Circuit decisions that allowed depletion in such cases. *Parsons v. Smith*, 255 F.2d 595; *Huss v. Smith*, 255 F.2d 599.

When the taxpayers then sought and obtained certiorari on the footing of the inter-circuit conflict (*Parsons v. Smith*, No. 218, Oct. T. 1958, Pet. 9; *Huss v. Smith*, No. 305, Oct. T. 1958, Pet. 10), this Court affirmed the Third Circuit's denial of any depletion to the contract strippers. *Parsons v. Smith*, 359 U.S. 215.

In response to the contractors who urged that their contractual right to mine coal from the designated lands, and the use of their equipment, organizations, and skills in doing so, should be regarded as the making of a capital investment in, and the acquisition of an economic interest in, the coal in place, the Court said (359 U.S. at 225):

But that fiction cannot be indulged here, for it is negated by the facts.

To recapitulate, the asserted fiction is opposed to the facts (1) that petitioners' investments were in their equipment, all of which was movable—not in the coal in place; (2) that their investments in equipment were recoverable through depreciation—not depletion; (3) that the contracts were completely terminable without cause on short notice; (4) that the landowners did not agree to surrender and did not actually surrender to petitioners any capital interest in the coal in place; (5) that the coal at all times, even after it was mined, belonged entirely to the landowners, and that petitioners could not sell or keep any of it but were required to deliver all that they mined to the landowners; (6) that petitioners were not to have any part of the proceeds of the sale of the coal, but, on the contrary, they were to be paid a fixed sum for each ton mined and delivered, which was, as stated in *Huss,* agreed to be in "full compensation for the full performance of all work and for the furnishing of all [labor] and equipment required for the work"; and (7) that petitioners, thus, agreed to look only to the landowners for all sums to become due them under their contracts. The agreement of the landowners to pay a fixed sum per ton for mining and delivering the coal "was a personal covenant and did not purport to grant [petitioners] an interest in the [coal in place]." *Helvering v. O'Donnell,* 303 U.S. 370, 372. Surely these facts show that petitioners did not actually make any capital investment in, or acquire any economic interest in, the coal in place, and that they may not fictionally be regarded as having done so.

That ruling should have marked the end of all further efforts on the part of contract miners to obtain a deduc-

tion for depletion. But, unhappily for the state of the law, it was not.

C. The Fourth Circuit refused to be convinced, and by concentrating on particular incidents of the several contract coal miners' arrangements, in effect overruled *Parsons v. Smith*

The first contract coal miner's case to reach the Fourth Circuit following *Parsons v. Smith* was *United States v. Stallard,* 273 F.2d 847, where the decision in the district court had gone in favor of the contractor. That ruling was reversed, the contract coal miner's claim to depletion was denied, and the Court of Appeals duly quoted from *Parsons v. Smith.* But the heart of its decision was not the difference between obtaining by investment an economic interest in the coal in place as against obtaining the mere economic interest in the enterprise that under this Court's rulings and the applicable Treasury Regulations was a mere economic advantage. To the contrary, the Fourth Circuit's first post-*Parsons* ruling turned on the terms of the contract, and once more disregarded the fundamentals underlying allowance of the depletion deduction (273 F.2d at 851):

> If the operator has the absolute and exclusive right under the contract to exhaust the deposit, it is usually held that he has an economic interest in the mineral which entitles him to a depletion allowance, but if the owner has the right under the contract to terminate the relationship at will, the operator is deemed to be an employee of the owner or an independent contractor compensated at a specified rate with no right to the deduction.

Next, in *McCall v. C.I.R.,* 312 F.2d 699, the Fourth Circuit emphasized the importance of terminability over

every other consideration, and, because of a 30-day cancellation clause in the contract, denied the contract miner's claim to depletion.

Very shortly afterwards, in *Elm Development Co. v. C.I.R.*, 315 F.2d 488, the Fourth Circuit took a new tack in favor of the contract miner. It held that the stripper's right under its contract to mine to exhaustion, without any risk of termination, entitled it without more to a share of the depletion allowance (p. 491): "Its right to mine the coal without risk of cancellation is its economic interest in the coal in place." Nothing here about acquiring that interest by investment, which this Court's decisions and the Treasury Regulations required; all that was ventured was that the Fourth Circuit's earlier contract miner cases that disregarded the significance of terminability had been overruled by *Parsons v. Smith*; *see* 315 F.2d at 490-91.

Finally, in *Merritt v. C.I.R.*, 330 F.2d 161 (together with *C.I.R. v. Paragon Jewel Coal Co.*), the Fourth Circuit interpreted the contract miners' arrangements as meaning that (p. 163):

> * * * the operators had a continuing right to produce the coal and to be paid therefor at a price which was closely related to the market price. By virtue of these contracts and their respective expenditures under them, the operators shared with Paragon an economic interest in the mineral which brings them within the rationale of Parsons v. Smith * * *.

And that ruling was followed in *Cooper v. C.I.R.*, 330 F.2d 163, decided on the same day.

In actual effect, therefore, the Fourth Circuit was merely paying lip service to *Parsons v. Smith*, while simultaneously—and actually—wholly disregarding its teaching. But correction was now not long delayed.

D. This Court's reversal of the Fourth Circuit in *Paragon Coal Co. v. Commissioner*, 380 U.S. 624, established the immateriality both of contract terminability and of any contractual right to mine to exhaustion

When the *Merritt/Paragon Jewel* case was reviewed here, reversal came promptly.

First, the Court reaffirmed the rationale of *Parsons v. Smith,* and showed without difficulty how it had been improperly disregarded by the Fourth Circuit. Accordingly, the decision sustained the depletion claim of Paragon Jewel, lessee and sublessee of the coal lands in question, and disallowed the claims of its contract miners, the Merritts.

Second, the Court was assisted in reaching its conclusion by the circumstance that later revenue legislation had allowed depletion to contract cutters of timber without any mention of contract miners of coal (380 U.S. at 637).

Third, the Court was similarly assisted by other legislation that had made the depletion exclusively available to coal lessees and sublessees, relegating coal lessors to capital gains treatment on their royalties in return for loss of any deduction for depletion (380 U.S. at 636-37). (This is a matter that we discuss further under Point V below, at pp. 43-47.)

Finally, the Court's decision at long last laid to rest the significance formerly accorded to terminability and to the right to mine to exhaustion.

It will be recalled that, in *Parsons v. Smith,* one of the seven indicia there pointed out to negative the strippers' right to depletion (359 U.S. at 225, quoted

above at p. 22) was "(3) that the contracts were completely terminable without cause on short notice; * * *."

In *Paragon*, however, the Court said (380 U.S. at 630, 634):

> The contracts were also silent regarding termination and were apparently for an indefinite period. However, numerous contractors quit mining, and some sold their equipment, buildings, tracks, etc., to others.
>
> * * *
>
> In *Parsons* the contract was expressly terminable on short notice; here no specific right to terminate was mentioned in the agreement between the parties. However, as the Court of Appeals noted, "the contracts did not fix upon the operators an *obligation* to mine to exhaustion." In fact, many of them quit at any time they chose. [Italics in original.]

Further, said the Court (380 U.S. at 634-35):

> In any event, the right to mine even to exhaustion, *without more*, does not constitute an economic interest under *Parsons*, but is "a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit." *Helvering v. Bankline Oil Co.*, 303 U.S. 362, 367 (1938).

Here we have ourselves italicized the words "without more" to contrast the situation of the contract miners in *Paragon Coal* with that of the lessee Black Hawk in the present case.

It is accordingly plain that this Court did not consider terminability or otherwise, or a right to mine to exhaustion or otherwise, as determinative factors in assessing

the contract miners' claims to a portion of the depletion allowance.[2]

Unhappily, however, as the present litigation demonstrates, so much had been said in so many now discredited cases about the significance or otherwise of terminability provisions in contract miners' agreements that, although the Fourth Circuit at long length acquiesced in reversal in the contract miner situation, *see Lawson v. C.I.R.*, 350 F.2d 396, other courts, differing from the rulings of the Court of Claims in *Bakertown* and in the present case, have continued to concentrate on terminability provisions, not in connection with mere mining contracts, but in dealing with *bona fide* leases such as are in question here.

Those courts in conflict with the Court of Claims have thus wholly disregarded the true basis for allowing or denying the depletion deduction, namely, whether the taxpayer had acquired, by investment, an economic interest in the wasting asset, the coal in place. The contract miners, who lacked such an interest, did not become entitled to the deduction simply because their contracts happened not to be terminable; that much is clear from this Court's decisions. Similarly, we shall now show that the respondent lessee here, which plainly had such an interest, did not lose its entitlement to a depletion deduction simply because its lease, though theoretically terminable without any grounds assigned, was not in fact cancelled during the tax years involved.

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[2] *Cooper v. C.I.R.*, 330 F.2d 163, decided by the Fourth Circuit on the same day as the *Paragon/Merritt* case, was reversed here on the Commissioner's petition for certiorari, without argument, on the authority of *Paragon Coal.* 381 U.S. 274.

IV.

RESPONDENT BLACK HAWK, A LESSEE OF COAL LANDS THAT MINED ITS LEASE TO EXHAUSTION OVER A 13-YEAR PERIOD, COULD NOT BE DEPRIVED OF ITS STATUTORY RIGHT TO A DEPLETION DEDUCTION SIMPLY BECAUSE OF A MUTUAL CANCELLATION CLAUSE IN ITS LEASE THAT WAS NEVER INVOKED OR EXERCISED OVER ALL OF THOSE YEARS

A. The lease here and the 13 years' dealings thereunder during which the leased coal tract was mined to exhaustion show that, under the Internal Revenue Code, the Treasury Regulations, and the decisions of this Court, respondent Black Hawk acquired by investment an economic interest in the coal in place, and thus became entitled to deduct for depletion of that wasting asset

Briefly to summarize what is set forth in more detail above (pp. 2-3), Black Hawk became lessee of coal lands in 1964, which by 1976 it had mined to exhaustion. The lease contained provisions for termination in the event of specified defaults, as well as a clause that permitted mutual cancellation by both parties without grounds assigned. But none of the termination provisions was ever invoked or exercised during all of the 13-year period during which Black Hawk mined its tract to exhaustion.

All of the actual mining was done by independent contractors. But neither the independent contractors nor the lessor have claimed any depletion allowance; the lessee Black Hawk is the only party to the enterprise that has sought to deduct for depletion.

On those facts we can dismiss the complications that arose when oil and gas interests were fractionalized, as well as the incidents involved in the contract miners' extended campaign to obtain depletion in respect of an asset they had never owned. Here the relevant residue of this Court's decisions clearly demonstrates that the undisputed facts just capsulated constitute the essential prerequisite to the allowance of a depletion deduction, namely, the acquisition by investment of an economic interest in the coal in place.

And that is precisely what the Court of Claims said in its earlier *Bakertown* decision (485 F.2d at 642), a decision followed here (Pet. 5a):

> Through the leases which they held, plaintiffs acquired an interest in the coal in place. The leases authorized them to extract and dispose of the coal underlying the leased premises to whomever and at whatever prices they chose. The income which they received was solely derived from and tied to the extraction and sale of the coal during the taxable years involved. The existence of these factors is sufficient to constitute a depletable interest under the rules that have been laid down by the Supreme Court from *Lynch v. Alworth-Stephens* [267 U.S. 364] and *Palmer v. Bender* [287 U.S. 551] to the present time.

Those rules can also be found in Treas. Reg. § 1.611-1 (b)(1), set forth at U.S. Br. 2a, of which this Court said when it was being considered in the *Paragon Coal* case, 380 U.S. at 636: "This Regulation has survived through successive amendments of the Internal Revenue Code and therefore is entitled to great weight."

We agree—and we urge that its weight cannot properly be minimized now. For, significantly, there is not a single word in that Regulation, nor for that matter in

any of this Court's depletion decisions, which suggests that the economic interest contemplated is diminished in any degree simply because of the presence of cancellation clauses that are never exercised.

Again significantly, there is not a single whisper anywhere in the multitudinous provisions of the current Internal Revenue Code dealing with percentage depletion suggesting or even intimating that a mineral lessee loses its entitlement to a deduction for depletion simply because its lease contains an unexercised cancellation clause. In this connection, we invite inspection of §§ 611(a) and 613(a), both at U.S. Br. 1a; and of §§ 613(c), 614(a), and 631(c), set forth below at App. 1a-3a. Not a single syllable in any of those sections so much as mentions a terminability clause.

Attention may be properly directed to Section 614(a), I.R.C. 1954, which provides as follows:

> **§ 614. Definition of property**
>
> **(a) General rule.**— For the purpose of computing the depletion allowance in the case of mines, wells, and other natural deposits, the term "property" means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land.

Again, there is not the slightest suggestion in the Internal Revenue Code that property ceases to be such simply because the interest owned by the taxpayer is subject to termination, much less when there has never been any termination.

The short of the matter is that the Government's contentions in the present case, which urge that the mere presence of an unexercised termination provision negatives not only property in a mineral deposit but also the right to a depletion allowance thereon, are entirely at

variance with what the Congress, the Treasury Department, and this Court have consistently decreed.

B. Expressions as to the significance of termination clauses that are taken from inapplicable and now wholly discredited contract coal miner cases are simply irrelevant in the present lease situation

As we have shown in our recital under Point III, pp. 19-27 above, the ultimately unsuccessful efforts of contract coal miners to share in the depletion allowance, in respect of a mineral asset in which they had absolutely no shred of ownership, led to emphasis on numerous subsidiary factors such as, preeminently, the terminability or otherwise of the mining contracts in question.

The decision in *Parsons v. Smith,* 359 U.S. 215, should have been enough to dispose of the contract miners' claims, but in view of the intractable backsliding of the Fourth Circuit in that area, it required *Paragon Coal Co. v. Commissioner,* 380 U.S. 624, to do so—and, in the process, to demonstrate the immateriality of whether or not the contract miners' arrangements were terminable.

None the less, considerable insight can still be derived from examining the basically irreconcilable decisions of the several Courts of Appeals concerned. Thus, the Third Circuit, whose general approach won approval in *Parsons v. Smith,* had stressed the significance of terminability (*Parsons v. Smith,* 255 F.2d 595, 597; *Huss v. Smith,* 255 F.2d 599, 601; *cf.* dissent at 602). Contrariwise, the Fourth Circuit, whose more sympathetic approach to contract miners' tax problems was so resoundingly disapproved in *Paragon Coal,* had earlier minimized the mere existence of a termination clause (*Weirton Ice & Coal Sup. Co. v. C.I.R.,* 231 F.2d 531,

535). Later, in *Stilwell v. United States,* 250 F.2d 736, the Fourth Circuit stressed non-terminability as the decisive factor in a contract coal miner's case. After that, following this Court's *sub silentio* disapproval of the Fourth Circuit's basic approach in contract miner cases, that tribunal then undertook to emphasize terminability to the exclusion of all other factors. *United States v. Stallard,* 273 F.2d 847, 851; *McCall v. C.I.R.,* 312 F.2d 699, 703-06; *Elm Development Co. v. C.I.R.,* 315 F.2d 488, 489-91; *Merritt v. C.I.R.,* 330 F.2d 161, 162-63; *Cooper v. C.I.R.,* 330 F.2d 163, 164.

Finally, when the last two cases cited were reversed here (*Paragon Coal Co. v. Commissioner,* 380 U.S. 624; *Commissioner v. Cooper,* 381 U.S. 274), this Court demonstrated the utter immateriality of terminability or otherwise (*Paragon Coal,* 380 U.S. at 630, 634-35, quoted above at p. 26).

The core of the matter is that contract miners do not have any economic interest in the coal in place, while lessees do. Contract miners in consequence have no right to depletion, since they never had any ownership in the wasting minerals (*cf. Thomas v. Perkins,* 301 U.S. at 661, "Ownership was essential"); lessees however do, as under § 614(a), I.R.C., quoted above at p. 30. they have "property" in the mineral deposit.

The result is that the contract miner cases are wholly irrelevant, and entirely out of point, in situations involving leases. Yet the Government makes precisely that error in the authorities it adduces in the present lease case.

Thus, *Costantino v. Commissioner,* 445 F.2d 405 (C.A. 3), cited at U.S. Br. 19, involved simply a contract miner. And each of the six cases cited in the first paragraph of U.S. Br. 22 is likewise a contract miner case,

three of which have already been discussed above: *Stallard,* 273 F.2d 847 (C.A. 4); *McCall,* 312 F.2d 699 (C.A. 4); *Usibelli,* 229 F.2d 539 (C.A. 9). But the newly adduced decisions are in no sense different: *United States v. Wade,* 381 F.2d 345 (C.A. 5); *Ramey v. Commissioner,* 47 T.C. 363, *aff'd,* 398 F.2d 478 (C.A. 6); *Rissler & McMurry Co. v. United States,* 480 F.2d 684 (C.A. 10). These likewise involved only contract miners, not lessees.

Therefore each of the authorities relied on by the Government for reversal here involves, not leases such as were held by Black Hawk and the other respondents here, who qualify under the Internal Revenue Code and the Treasury Regulations and this Court's decisions for a depletion allowance, but only contract miners, whose claims this Court decisively rejected, first in *Parsons v. Smith,* 359 U.S. 215, and then again in *Paragon Coal Co. v. Commissioner,* 380 U.S. 624, because not a single one of those contract miners had the slightest economic interest in the coal in place.

It follows that all of the foregoing decisions put forward by the Government are quite without relevance to the issue now before the Court.

Similarly, *Mullins v. Commissioner,* 48 T.C. 571, also relied on by the Government here (U.S. Br. 19), although it did indeed involve a lease, was rested (48 T.C. at 583) on contract miner cases: *Stallard,* 273 F.2d 847 (C.A. 4); *McCall,* 312 F.2d 699 (C.A. 4); and *Stilwell,* 250 F.2d 736 (C.A. 4). But the Tax Court's authorities were not only irrelevant contract miner cases, each of the three had already been discredited by this Court's subsequent decisions in *Parsons* and in *Paragon Coal.* Indeed, the Tax Court was apparently wholly unaware that Stilwell, whose claim the Fourth Circuit had allowed in 250 F.2d,

was a Paragon Coal contractor whose arrangements were identical with those of the Merritts, other Paragon Coal contractors, who came a cropper in the *Paragon Coal* case here, 380 U.S. 624.

Accordingly, when the Court of Claims first faced the terminable-but-unterminated lease situation now presented in this case, it quoted with approval Chief Judge Drennen's dissent in the *Mullins* case (*Bakertown Coal Co. v. United States*, 485 F.2d 633, 641, quoting from 48 T.C. at 584-85), and refused to follow the Tax Court.[3]

The short of the matter is that, if attention be focused on the acquisition, by investment, of an economic interest in the mineral in place, which is the only property that qualifies for a depletion allowance, the contract miner cases are wholly out of point: They are entirely irrelevant since it is now at long last entirely clear that contract miners have no such interest and hence are entitled to no such allowance.

Consequently, whatever was earlier said by some of the lower federal courts in contract miner cases about the significance or otherwise of termination clauses, expressions antedating the ultimate denial here of contract miners' claims to depletion, becomes wholly irrelevant here, where the respondent lessee plainly has the requisite economic interest. And to inject those now disapproved and quite inapplicable expressions here, as the Government does in its brief, is simply to introduce counterproductive clutter into the discussion.

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[3]It needs to be pointed out that it was Judge Drennen's decision in the *Paragon Coal/Merritt* controversy (39 T.C. 257) which, after reversal by the Fourth Circuit (330 F.2d 161), was reinstated by this Court (380 U.S. 624, 626).

In its earlier *Bakertown* decision, on which its ruling in this case was rested (Pet. 8-9, 5a; U.S. Br. 6-7, 19-20), the Court of Claims said precisely what we have just set forth immediately above (485 F.2d at 636):

> It seems to us that the Government is here attempting to remove transactions from the traditional ambit of economic interest by resort to a principle that it sponsored to liberalize and expand that established concept to encompass transactions not theretofore within it. The erroneous transposition is as between lessees; persons who have acquired the right to remove and retain mineral underlying the leased premises, and mining contractors who, although functionally involved in the production of saleable mineral (and therefore financially interested in the life of the deposit as a source of continuing need for their services), have no effective authority over production and acquire no ownership of the extracted mineral.

C. Inasmuch as the present lease obviously qualifies for the depletion deduction in respect of all the tax years here involved, the unexercised termination clause is a matter of abstraction and not of reality

At the time of the tax years here involved, 1970 through 1972, Black Hawk's lease had been in force from seven to nine years. That lease was never sought to be terminated during those tax years, and in fact Black Hawk continued to mine for four years more, stopping only in 1976 when all the coal feasible to mine had been extracted (J.A. 71a, ¶ 8).

If we bear in mind what the Court said in another depletion case (*Commissioner v. Southwest Exploration Co.*, 350 U.S. 308, 315), that "the tax law deals in

economic realities, not legal abstractions," then it is plain that, during the tax years now in litigation, Black Hawk had a depletable interest. The Court of Claims so held twice, first in *Bakertown* and then again here. We submit that it properly regarded the mere existence of a termination clause that was never invoked or exercised during the tax years as—to quote Mr. Justice Holmes in another connection (*Myers v. United States*, 272 U.S. 52, 177)—"spider's webs inadequate to control the dominant facts."

Accordingly, the Court of Claims was clearly right, and we find a convincing rationale for its conclusion in a Fourth Circuit case which, although plainly not law today as to its substance, nonetheless persuasively emphasizes the importance of looking to the tax years involved. *See Weirton Ice & Coal Sup. Co. v. C.I.R.*, 231 F.2d 531, 535:

> It is of no moment that the owner of the mineral, as in other cases in which the right of an extractor to a deduction for depletion has been upheld, had the option to terminate the arrangement at any time, for as the event proved, Weirton actually mined the coal during all of the taxable years.

Although the Fourth Circuit later disapproved this and similar expressions, disapproval that was a consequence of its own erroneous reading of *Parsons v. Smith*, 359 U.S. 215, as turning solely on terminability, *see Elm Development Co. v. C.I.R.*, 315 F.2d at 490, we submit that the passage just quoted sets forth the correct approach.

Indeed, that concentration on the tax years actually involved in the litigation, without regard to possibilities that never in fact materialized, was foreshadowed, and applied, in the first depletion case decided by this Court, *Lynch v. Alworth-Stephens Co.*, 267 U.S. 364. The emphasis in that decision was uniformly on the taxable

year actually in issue; we quote some representative passages from the opinion (pp. 369–70):

> the product thereof mined and sold during the taxable year
>
> * * *
>
> its right to deduct a reasonable allowance for exhaustion of such property, if there be any, during the taxable year
>
> * * *
>
> the depletion of the mines during the taxable year
>
> * * *
>
> the product thereof which has been mined and sold during the year for which the return and computation are made

And the same focus on the tax year in litigation appears in the precise terms of the opinion in *United States v. Ludey,* 274 U.S. 295, 302, from which quotation has already been made:

> The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year * * *.

We can test the teaching of the foregoing rulings by supposing a ten-year mineral lease, running let us say from January 1, 1969, through December 31, 1978, in which the tax years being contested are 1973 through 1975. Suppose further that this lease was terminated on June 30, 1977, because the lessee ceased to pay royalties; could it be supposed for a moment that the lessee would in consequence lose his depletion deduction for the earlier tax years that are in dispute? Plainly not, so what difference of substance would there be if the lease instead of being terminated for non-payment had been cancelled on the same or on a later date simply because the lessor, acting on whim, had sought to resume mining himself or through the agency of a contractor not

previously employed by the lessee? Again, suppose that the lessee himself took advantage of the cancellation clause to terminate the lease on June 30, 1977: In all those instances, the answer must be, There is no difference, and the lessee is still entitled to his depletion deduction for the earlier tax years that are being litigated.

How then, it may be asked, does the right to depletion succumb to the mere overhanging threat of a termination clause that is never even exercised, either during the tax years in litigation, or afterwards?

Some thirty years ago, the Treasury ruled that, if a contractor were assured of at least twelve months of uninterrupted mining, it would be entitled to depletion. GCM 26290, 1950-1 Cum. Bull. 42. The Tax Court since then has drawn a finer line. It has held that a 30-day or a 60-day cancellation clause is fatal, although a termination provision requiring 120 days' notice does not deprive a mineral lessee of his deduction for depletion. *Weaver v. Commissioner,* 72 T.C. 594, 608-09. We confess ourselves quite unable to find, either in the statutes or in the applicable regulations or in this Court's decisions, the slightest basis for distinctions so ephemeral and so imaginatively fanciful.

The Court of Claims in this case decided that a 30-day cancellation clause would not be fatal, because (Pet. 8a) "We cannot say *a priori* that a month's period is too short for a miner to expect to extract a substantial amount of coal. There is no such proof before us and we do not believe it is a matter of judicial notice. Like *Bakertown,* these cases do not involve leases terminable within a single day."

Like *Bakertown* (485 F.2d at 642):

> This is not a case in which we are called upon to decide whether plaintiffs would be entitled to

> recover if the duration of their leases was for only one day, or if their leases were terminable at the will of the lessor without advance written notice and without cause.

Nor need this Court decide or even speculate about such a hypothetical situation, for the excellent reason that no individual or corporate lessee would ever agree to any such economically impossible arrangement. For as this Court has said (350 U.S. at 315, quoted above at pp. 35-36), "the tax law deals in economic realities, not legal atstractions."

The reality here is that, for the three tax years now in question, for the six years preceding, and for the four years following until the coal underlying the leased tract had been mined to exhaustion, Black Hawk's lease was never terminated.

D. To attach any significance whatever to wholly unexercised termination clauses in coal leases would inevitably risk a repetition of the confusion that permeated the contract coal miner cases over so many years

We noted above, p. 18, the confusion that characterized the two oil depletion cases decided at the 1945 Term, *Kirby Petroleum Co. v. Commissioner*, 326 U.S. 599, and *Burton-Sutton Oil Co. v. Commissioner*, 328 U.S. 25. The result in the latter case impelled one member of the Court to say (328 U.S. at 38):

> Nothing better illustrates the gossamer lines that have been drawn by this Court in tax cases than the distinction made in the Court's opinion between *Helvering v. Elbe Oil Land Co.*, 303 U.S. 372, and this case. To draw such distinctions, which hardly

> can be held in the mind longer than it takes to state them, does not achieve the attainable certainty that is such a desideratum in tax matters, nor does it make generally for respect of law.

Interestingly enough, it was precisely what this Court had said in *Burton-Sutton,* involving oil, that impelled two separate circuits to concede a depletion allowance to contract coal miners in the earliest decisions involving such claims, cases that *Parsons v. Smith,* 359 U.S. 215, and *Paragon Coal Co. v. Commissioner,* 380 U.S. 624, have now clearly shown to have been wrongly decided. *See C.I.R. v. Gregory Run Coal Co.,* 212 F.2d 52, 55-61 (C.A. 4), and *C.I.R. v. Mammoth Coal Co.,* 229 F.2d 535, 537 (C.A. 3).

In the latter two decisions, as we have already shown at length, pp. 19, 21, above, principle was forgotten in concentration on particular incidents, with resultant confusion that extended through a decade of litigation. That far from glorious episode in the hammering out of the law of depletion would surely be repeated now if, as the Government urges here, the reality of the lessee's economic interest in the coal in place were brushed aside in favor of simply fixing on a particular incident of its lease, namely, a clause therein that neither of the parties ever made operative.

Two factors, we think, contributed to the turbulence found in the earlier depletion cases.

First, emphasis was too often placed, not on clear rules, not on broad principles, but on "the circumstances of this case" (*Commissioner v. Southwest Exploration Co.,* 350 U.S. 308, 317), and on "the facts" and "these facts" (*Parsons v. Smith,* 359 U.S. 215, 225). Thus, inevitably, there was engendered an emphasis on the amorphous totality of each separate tax litigation,

encouraging first counsel and then the courts to pick and choose from among particular incidents that seemed most likely to lead to the result desired. Thus, after the Fourth Circuit's basic pro-contract-miner approach had been disapproved in *Parsons v. Smith,* it interpreted that decision as making all contract miner cases turn on terminability—even though, as the *Parsons* opinion shows, terminability was only one out of seven enumerated elements considered.

The second factor contributing to the confusion was perhaps inevitable in the context of tax litigation. As phrased by Judge Goodrich in *Denise Coal Co. v. C.I.R.*, 271 F.2d 930, 933 (C.A. 3), "Both stripper and owner may not have the depletion allowance. The Commissioner seems to take the position of opposing either party who demands it." Otherwise stated, the chief tax official never sought to formulate official tax guidelines. It was only when both claimants happened to become parties to consolidated proceedings that the Commissioner ever took a doctrinal position (*Southwest Exploration,* 350 U.S. at 309 note 1; *Paragon Coal,* 380 U.S. at 626 note 2).

In order to preclude similar confusion in what we may call the new generation of coal depletion cases, now that lessors are denied depletion by statute and the contract miners have finally been eliminated as contenders, we strongly urge that the errors of the past be not repeated in cases such as this one that involve leases.

In the earlier cases, the mistake arose because the circumstance that the contract miners' economic interest was not in the coal in place was ignored, and attention became riveted on the terminability and other incidents of their contracts. Today a similar mistake would be repeated if the Court were now to ignore the circum-

stance that the lessee clearly has a depletable interest in the coal that it mined during the tax years, and were to look only at a termination clause in its lease that in fact never became operative. And confusion would be worse confounded were particular emphasis to be placed on the time specified in such unexercised clause, so that the right to depletion would turn on whether that wholly hypothetical event required a notice of one, or two, or four months—as the Tax Court is now deciding, *see Weaver v. Commissioner*, 72 T.C. 594, 608-09. Indeed, such an approach would signal a return to the "gossamer lines" about which Mr. Justice Frankfurter so presciently complained in *Burton-Sutton*, 328 U.S. at 38, *supra* pp. 39-40.

If we accept the proposition first announced by Mr. Justice Holmes just a century ago (*The Common Law* [1881] 1), that the life of the law has been experience, then the painful years of hammering out the contract coal miners' non-entitlement to depletion should warn against acceptance of the purely hypothetical propositions and the tenuous distinctions now being advanced in coal lessee cases by the Government here, by the Third Circuit in its ill-starred *Whitmer* case (443 F.2d 170), and by the Tax Court in a series of decisions that obviously ignore settled principles in favor of discredited earlier cases, irrelevant incidents, and untenable distinctions.

V.

IN VIEW OF § 631(c), I.R.C. 1954, WHICH GRANTS CAPITAL GAINS TREATMENT TO COAL LESSORS, BUT THEN SPECIFICALLY PROVIDES THAT SUCH LESSORS "SHALL NOT BE ENTITLED TO THE ALLOWANCE FOR PERCENTAGE DEPLETION PROVIDED IN SECTION 613 WITH RESPECT TO SUCH COAL," THE COURT OF CLAIMS WAS PLAINLY CORRECT IN STATING THAT, UNLESS THE LESSEE HERE WAS ALLOWED DEPLETION, THERE WOULD BE NO DEPLETION DEDUCTION FOR ANYONE DESPITE THE EXHAUSTION OF ALL THE COAL UNDERLYING THE LEASED LANDS; AND THE GOVERNMENT'S ARGUMENT TO THE CONTRARY SIMPLY IGNORES THE EXPLICIT TERMS OF THE STATUTE

A. Since 1951, lessors of coal lands have been granted capital gains treatment of their royalties in lieu of any depletion depletion allowance

As we have shown (pp. 12-13, above), successive revenue acts from 1918 down to the present day have provided for apportionment of the depletion allowance in the case of leases. But in 1951, Congress made a significant change in respect of coal leases, providing that, instead of being allowed part of the depletion deduction as theretofore, the lessor would be granted capital gains treatment on his royalties but in return would no longer be permitted to deduct for depletion. *See* § 325 of the Revenue Act of 1951, P.L. 183, 65 Stat. 452, 501 (App. 5a-6a). That new provision was clarified in the 1954 Internal Revenue Code in respects not presently material, and in 1964 iron ore was included within its scope.

In its present form, § 631(c), I.R.C. 1954, that provision appears at App. 2a-3a. The portion pertinent here is the sentence reading:

> Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal or iron ore.

This provision is adopted in Treas. Reg. § 1.631-3(b)(1) (App. 5a).[4]

It was unquestionably because of the provision just quoted, the operative language of which has remained unchanged since 1951, that Black Hawk's lessor never made any claim for percentage depletion (J.A. 71a, ¶ 10). For, obviously, no such claim could possibly have succeeded in the face of what has just been set forth.

B. Accordingly, as the Court of Claims pointed out, denial of depletion to the lessee here would mean that, although the entire leased tract was mined to exhaustion over a 13-year period, no depletion allowance thereon could be given anyone

In the *Paragon Coal* case, 380 U.S. 624, the contest for a share of the depletion allowance took place between the lessee/sublessee on the one hand and the contract miners on the other; the latter group lost. In the course

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[4] *See also* Treas. Reg. § 1.611-1(b)(2) which provides:

"(2) No depletion deduction shall be allowed the owner with respect to any timber, coal, or domestic iron ore that such owner has disposed of under any form of contract by virtue of which he retains an economic interest in such timber, coal, or domestic iron ore, if such disposal is considered a sale of timber, coal, or domestic iron ore under section 631(b) or (c)."

of its opinion, the Court made mention of the 1951 coal amendments as an additional ground in support of its conclusions, *see* 380 U.S. at 636-37, and that reference was noted by the Court of Claims in the earlier *Bakertown* case, 485 F.2d at 642.

In the present case, as has just been noted, Black Hawk's lessor made no claim for depletion; it could not do so in the face of § 631(c). Here, likewise, the contract miners made no claim for depletion (J.A. 71a, ¶ 10); they could not do so either after the *Paragon Coal* decision, 380 U.S. 624.

Accordingly, both in the earlier *Bakertown* case (485 F.2d at 642) as well as here (Pet. 9a), the Court of Claims pointed out that if the lessees "are not entitled, there will be no depletion on the coal mined under these leases." And it also said here (*ibid.*), in answer to the Government's argument that every applicant must show its own entitlement, "We agree, but think that Congress, in establishing percentage depletion, intended that, except for extraordinary instances, someone should be entitled to depletion on all mined coal covered by the Code provision. *Cf.* I.R.C. § 613(c)."

This Court, from *Lynch v. Alworth-Stephens Co.*, 267 U.S. 364, and *United States v. Ludey*, 274 U.S. 295, down through *Paragon Coal Co. v. Commissioner*, 380 U.S. 624, has iterated and reiterated that the purpose of the depletion allowance is to compensate for the loss of a wasting asset used up in the course of producing income. Surely it would be monstrous to hold here that, after all the coal had been mined to exhaustion over a 13-year period, the only party now entitled by law to depletion, the lessee Black Hawk, should lose that entitlement simply because of a mutual termination

clause that was never availed of by either party during all of those years. Any such result would completely frustrate the oft-expressed intent of Congress to compensate the owner of a wasting asset.

C. The Government's argument that the lessor here is entitled to both capital gains plus depletion allowance in addition simply ignores the clear and explicit terms of § 631(c)

The Government argues (U.S. Br. 22) that "there is no basis for the Court of Claims' observation * * * that if respondents are not entitled to the depletion deduction, 'there will be no depletion on the coal mined under these leases' (Pet. App. 9a)."

The Government then goes on to assert (U.S. Br. 23) that "the capital gains treatment to which the lessors would be entitled under Section 631(c) does not deprive them of the benefits of depletion," citing four cases that do not have the slightest bearing on that provision either as it now stands or as it was first enacted in 1951:

(a) Two of its cases antedate 1951: *Burnet v. Harmel*, 287 U.S. 103 (1932); *Herring v. Commissioner*, 293 U.S. 322 (1934).

(b) A third case cited, *Parsons v. Smith*, 359 U.S. 215, although decided in 1959, involved the tax years 1945-49, which of course antedated 1951; *see* No. 218, Oct. T. 1958, R. 8-10. The companion case decided with *Parsons*, *Huss*, dealt with the tax years 1944-47; *see* the recital in *Huss v. Smith*, 150 F. Supp. 224, 266-27 (E.D. Pa.).

(c) The last case cited, *Commissioner v. Southwest Exploration Co.*, 350 U.S. 308, involved oil and not

coal—and neither § 631(c) nor its 1951 predecessor has any application whatever to lessors of oil or gas lands.

Plainly, therefore, the Government's authorities do not and cannot support its proposition of double entitlement for coal lessors for which they are cited.

What the Government never mentions, and to which we feel constrained to direct its attention, is the portion of § 631(c) which completely demolishes its double entitlement contention:

> Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal or iron ore.[5]

The short of the matter is that the Government's contention that a coal lessor is entitled to depletion as well as to capital gains simply flies in the face of the plain language of Section 631(c). There is no need to belabor that matter further.

The result is that the Court of Claims was correct in saying that, if lessee Black Hawk received no depletion, no one else could. And, for the reasons fully set forth above, the Court of Claims was also correct in holding that the lessee Black Hawk, which had mined to exhaustion all of the coal underlying its lease over a 13-year period, was entitled under statute, regulations, and decisions here, to deduct for depletion—and that this

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[5]The committee reports do not add much if anything to the statutory language. *See* H.R. Rep. No. 586, pp. 31-32, 117-18; Sen. Rep. No. 781, Part 2, pp. 43-45; H.R. Rep. No. 1179, pp. 18, 77; all 82d Cong., 1st sess. But the sentence just quoted is so clear that any legislative comment thereon, serving only to repeat the obvious, would be quite unnecessary. Accordingly, as in *Greenwood v. United States*, 350 U.S. 366, 374, "this is a case for applying the canon of construction of the wag who said, when the legislative history is doubtful, go to the statute."

entitlement did not vanish into thin air simply because its lease might have been but in fact never was terminated during all of that time.

CONCLUSION

It is therefore respectfully submitted that the judgment below should be affirmed.

Respectfully submitted,

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APPENDIX

STATUTES AND REGULATIONS INVOLVED

(1) Internal Revenue Code of 1954 (26 U.S.C.)

Section 613(c). Percentage Depletion. Definition of Gross Income From Property.—For purposes of this section—

(1) Gross Income From the Property.—The term "gross income from the property" means, in the case of a property other than an oil or gas well and other than a geothermal deposit, the gross income from mining.

(2) Mining.—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

(3) Extraction of the Ores or Minerals from the Ground.—The term "extraction of the ores or minerals from the ground" includes the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining. The preceding sentence shall not apply to any such extraction of the mineral

or ore by a purchaser of such waste or residue or of the rights to extract ores or minerals therefrom.

(4) Treatment Processes Considered as Mining.—The following treatment processes where applied by the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611:

(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treatment to prevent freezing, and loading for shipment;

* * *

Section 614. Definition of Property.

(a) GENERAL RULE.—For the purpose of computing the depletion allowance in the case of mines, wells, and other natural deposits, the term "property" means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land.

Section 631(c). Disposal of Coal or Domestic Iron Ore With a Retained Economic Interest.—

In the case of the disposal of coal (including lignite), or iron ore mined in the United States, held for more than 1 year[1] before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal or iron ore, the difference between the amount realized from the disposal of such coal or iron ore and the adjusted depletion basis thereof plus the deductions disallowed for the taxable

---

[1] For taxable years beginning after December 31, 1977, the previous shorter holding periods were lengthened to one year. P.L. 94-455, § 1402(b)(2). Treas. Reg. § 1.631-3(a)(1) and (b)(1) does not reflect this change.

year under section 272 shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal or iron ore. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal or iron ore. This subsection shall not apply to income realized by any owner as a co-adventurer, partner, or principal in the mining of such coal or iron ore, and the word "owner" means any person who owns an economic interest in coal or iron ore in place, including a sublessor. The date of disposal of such coal or iron ore shall be deemed to be the date such coal or iron ore is mined. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. This subsection shall have no application, for purposes of applying subchapter G, relating to corporations used to avoid income tax on shareholders (including the determinations of the amount of the deductions under section 535(b)(6) or section 545(b)(5)). This subsection shall not apply to any disposal of iron ore—

(1) to a person whose relationship to the person disposing of such iron ore would result in the disallowance of losses under section 267 or 707(b), or

(2) to a person owned or controlled directly or indirectly by the same interests which own or control the person disposing of such iron ore.

(1) Treasury Regulations on Income Tax (26 C.F.R.)

Section 1.613-1. Percentage depletion; general rule.

In the case of a taxpayer computing the deduction for depletion under section 611 with respect to minerals

on the basis of a percentage of gross income from the property, as defined in section 613(c) and §§ 1.613-3 and 1.613-4, such deduction shall be the percentage of such gross income as specified in section 613(b) and § 1.613-2. The deduction shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). Such taxable income shall be computed in accordance with § 1.613-5. In no case shall the deduction for depletion computed under this section be less than the deduction computed upon the cost or other basis of the property provided in section 612 and the regulations thereunder. The apportionment of the deduction between the several owners of economic interests in a mineral deposit will be made as provided in paragraph (c) of § 1.611-1. For rules with respect to "gross income from the property" and for defintion of the term "mining," see §§ 1.613-3 and 1.613-4. For definitions of the terms "property," "mineral deposit," and "minerals," see paragraph (d) of § 1.611-1.

Section 1.631-3. Gain or loss upon the disposal of coal or domestic iron ore with a retained economic interest.

(a) *In general.* (1) The provisions of section 631(c) apply to an owner who disposes of coal (including lignite), or iron ore mined in the United States, held for more than 6 months before such disposal under any form or type of contract whereby he retains an economic interest in such coal or iron ore. The difference between the amount realized from disposal of the coal or iron ore in any taxable year, and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272, shall be gain or loss upon the sale of the coal or iron ore. See paragraph (b)(4) of this section for the definition of "owner." See paragraph (e) of this section for special rules relating to iron ore.

(2) In the case of such a disposal, the provisions of section 1231 apply, and the coal or iron ore shall be considered to be property used in the trade or business for the taxable year in which it is considered to have been sold, along with other property of the taxpayer used in the trade or business as defined in section 1231(b), regardless of whether the coal or iron ore is property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Whether gain or loss resulting from the disposition of the coal or iron ore which is considered to have been sold will be deemed to be gain or loss resulting from a sale of a capital asset held for more than 6 months will depend on the application of section 1231 to the taxpayer for the taxable year; *i.e.*, if the gains do not exceed the losses, they shall not be considered as gains and losses from sales or exchanges of capital assets but shall be treated as ordinary gains and losses.

(b) *Rules for application of section.* (1) For purposes of section 631(c) and this section, the date of disposal of the coal or iron ore shall be deemed to be the date the coal or iron ore is mined. If the coal or iron ore has been held for more than 6 months on the date it is mined, it is immaterial that it had not been held for more than 6 months on the date of the contract. There shall be no allowance for percentage depletion provided in section 613 with respect to amounts which are considered to be realized from the sale of coal or iron ore under section 631(c).

Revenue Act of 1951.

Section 325. Tax Treatment of Coal Royalties.—

(a) Definition of Property Used in the Trade or Business.—Section 117(j)(1) (relating to the definition of

property used in the business) is hereby amended by adding after the word "timber" in the second sentence thereof the following: "or coal."

(b) Gain or Loss Upon Certain Disposals of Timber or Coal.—Section 117(k)(2) (relating to the disposal of timber) is hereby amended to read as follows:

"(2) In the case of the disposal of timber or coal (including lignite), held for more than 6 months prior to such disposal, by the owner thereof under any form or type of contract by virtue of which the owner retains an economic interest in such timber or coal, the difference between the amount received for such timber or coal, and the adjusted depletion basis thereof shall be considered as though it were a gain or loss, as the case may be, upon the sale of such timber or coal. Such owner shall not be entitled to the allowance for percentage depletion provided for in section 114(b)(4) with respect to such coal. This paragraph shall not apply to income realized by the owner as a co-adventurer, partner, or principal in the mining of such coal. The date of disposal of such coal shall be deemed to be the date such coal is mined. In determining the gross income, the adjusted gross income, or the net income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this paragraph. This paragraph shall have no application, in the case of coal, for the purposes of applying section 102 or subchapter A of chapter 2 (including the computation under section 117(c)(1) of a tax in lieu of the tax imposed by section 500)."

Treasury Regulations 103 (issued under Internal Revenue Code of 1939)

Section 19.23(m)-1. Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.—Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciaion and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

Supreme Court, U.S.
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MICHAEL RODAK, JR.

No. 79-1515

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

UNITED STATES OF AMERICA, *Petitioner,*

v.

ELWOOD SWANK AND RITA SWANK

UNITED STATES OF AMERICA, *Petitioner,*

v.

BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA, *Petitioner,*

v.

BULL RUN MINING CO., INC.

On Writ Of Certiorari To The United States Court Of Claims

BRIEF FOR RESPONDENT BULL RUN MINING CO., INC.

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v.

BULL RUN MINING CO., INC.

On Writ Of Certiorari To The United States Court Of Claims

BRIEF FOR RESPONDENT BULL RUN MINING CO., INC.

STATUTES AND REGULATIONS INVOLVED

In addition to the statutes and regulations referred to by petitioner, Section 631(c) of the Internal Revenue Code of 1954, as amended (26 U.S.C.), is set forth in the Appendix, *infra,* at 1a.

STATEMENT OF THE CASE

Bull Run Mining Co., Inc., was engaged in mining coal in West Virginia during its tax year ending September 30, 1974. The mining was conducted under a lease agreement, dated June 21, 1967, between respondent as lessee and Preston County Coal and Coke Corporation as lessor (J.A. 90a). The lease was for a five-year term, renewable for an additional five years. The lease was in fact renewed for that additional five years plus a second five years. The renewal option in the lease was conditioned upon all of the coal not having been removed at the end of the original term of the lease. While the record indicates that respondent still is mining coal under the second five-year renewal (Br. in Opp. 10), in fact under the lease in question the coal was mined to exhaustion as of September 15, 1978, and the mine was sealed and approved by the West Virginia Department of Mines on September 30, 1978. This had not occurred either at the time respondent's petition was filed with the United States Court of Claims which was on July 27, 1977 (J.S. 87a) or at the time the depositions of respondent's witnesses were taken on April 26, 1978.

By the terms of the lease respondent had the right to mine coal on specified lands on condition that it pay a royalty to the lessor of 25 cents per ton of coal removed. Respondent was entitled to sell the coal which it mined under this lease to anyone for any price which it should choose without any restrictions or oral understanding between the lessor and the lessee (J.A. 91a). However, during the particular tax year involved respondent sold all the coal which it mined pursuant to the lease to the lessor because the lessor at that time presented the most favorable market for the lessee. In

other years, respondent sold the coal to buyers other than the lessee (Br. in Opp. 10-11; Repl. Br. to Cr. Mot. 3-6).

The proceeds from the sale of the coal represented the only source of revenue from which respondent could recover any rents and royalties paid to the lessor for the right to mine (J.A. 91a).

Pursuant to the lease, either party could terminate the lease within thirty days upon written notice (J.A. 96a). Also, pursuant to the lease, the lessee was obligated to mine in such a way that it would comply with West Virginia and United States law relating to mining, be an independent contractor, insulate the lessor from liability, and operate the mine in a workmanlike fashion so as to maximize production (J.A. 95a-96a). If any of those conditions were breached, the lease could be cancelled by the lessor wholly apart from the thirty-day termination clause. The thirty-day termination clause never was exercised; the lessee mined the coal to exhaustion under the lease from 1967 to the end of 1978.

On its federal income tax return for its tax year ending September 30, 1974, respondent claimed a depletion deduction of $39,981.41 with respect to the coal which it mined as lessee (J.A. 92a-93a). The lessor has not claimed any depletion allowance with respect to the coal mined by respondent during the tax year in question (J.A. 92a).

Petitioner's brief adequately covers the proceedings below regarding respondent. It should be pointed out, however, that the Court of Claims' decision in *Bakertown Coal Co.* v. *United States,* 485 F.2d 633 (1973), was rendered by the court sitting en banc with only one

dissent and not by a court closely divided. The court in *Bakertown* consisted of seven judges.

SUMMARY OF ARGUMENT

1. A bilateral thirty-day written notice termination clause of the kind in question here is only one of several factors, not the controlling factor, to be considered in determining whether a lessee has an economic interest in the coal in place so as to entitle it to the depletion allowance provided by Sections 611(a) and 613 of the Internal Revenue Code of 1954, as amended. Because the effect of such a clause on an otherwise admittedly depletable interest is the only issue on appeal, it is not necessary to delve into what the other factors may be or whether they are met, the government having conceded that all other factors necessary to establish an economic interest in respondent exist. If this Court should find that the termination clause is only one of several factors to review in determining whether an economic interest exists, then the judgment below should be affirmed.

2. Termination clauses of the type in question here do not invalidate an otherwise admittedly legitimate economic interest where the lessee clearly has acquired an interest in the mineral in place pursuant to a lease, as lessee, and must look to the market to recover its investment in the minerals in place. Most of the cases involving termination clauses of the kind in question here, where the depletion deduction was denied, are readily distinguishable on their facts, for there usually was at least one other factor which led the court to deny the depletion allowance. In those cases where no factual distinction can be made from the case at bar, or where it might appear that there was no factual distinction, the analysis of the lower court was in error as to the effect

of such a termination clause with respect to the acquisition of an economic interest. This has been caused in part by confusing the concept of cost or discovery depletion with percentage depletion.

3. Economic reality is the touchstone in all tax cases. The termination clause at issue never in fact was exercised over the period during which respondent mined the coal to exhaustion under the lease. Clearly the lessee had an interest in fact which permitted it to mine the coal to exhaustion. If, and until, the termination clause was exercised, respondent had an economic interest under the lease.

4. The lessor has not claimed any depletion allowance with respect to the coal mined by the lessee during the tax year in question. In fact, the lessor is prevented from so doing by reason of Section 631(c) of the Internal Revenue Code of 1954, as amended, because the lessor has treated receipt of the royalty payments under the lease as a sale. It was never the intent of Congress that no one be able to claim the depletion allowance. Should the government prevail in its position, no person would be able to claim the allowance. Because of the operation of Section 631(c) of the Internal Revenue Code of 1954, as amended, precluding the lessor from claiming the depletion allowance, the lessee is the only person who is entitled to claim it.

ARGUMENT

I. A Bilateral Thirty-Day Written Notice Termination Clause Is Only One Of Several Factors, Not The Controlling Factor, To Be Considered In Determining Whether A Lessee Has The Requisite Economic Interest To Entitle It To The Depletion Allowance

A deduction for depletion is allowed by Section 611(a) of the Internal Revenue Code of 1954, as amended, "according to the particular conditions in each case" under regulations prescribed by the Secretary of the Treasury. Treas. Reg. Sec. 1.611-1 Appendix, *infra,* at 3a, sets forth the general conditions for the allowance of depletion. Treas. Reg. Sec. 1.611-1(b)(1), Appendix, *infra,* at 3a, states that depletion will be allowed only to the owner of an economic interest.

The concept of an economic interest as a condition to taking depletion was first enunciated in *Palmer* v. *Bender,* 287 U.S. 551 (1933). At 557 in *Palmer*, this Court set forth the test so often quoted:

> The language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital.

The Court went on to say in discussing *United States* v. *Biwabik Mining Co.,* 247 U.S. 116 (1918):

> But this Court held that regardless of the technical ownership of the ore before severence, the taxpayer, by his lease, had acquired legal control of a valuable economic interest in the ore capable of realization as gross income by the exercise of his

> mining rights under the lease. Depletion was, therefore, allowed.

It is clear that the concept of an economic interest was incorporated in the regulations from the *Palmer* case. It is equally clear that this Court in *Palmer* intended the concept of an economic interest to be construed broadly. Based on the regulation as it stands, and on *Palmer*, where the taxpayer claiming depletion must look to the market place for a return of its capital investment, and where it holds rights to the mineral in the ground as a lessee pursuant to a bona fide lease, the taxpayer on those basis alone is entitled to the depletion deduction.

Even though the government's brief at pages 15-18 suggests that this Court has decided cases supporting the government's position, this Court has not been presented with a case involving a short-notice at will termination clause where the taxpayer was clearly a bona fide lessee as opposed to a mining contractor performing mining services for the owner of the coal. Nor is there anything in the Internal Revenue Code of 1954, as amended, or the Treasury Regulations to lend guidance in this type of fact situation.

Parsons v. *Smith,* 359 U.S. 215 (1959) is the only case in which this Court has dealt squarely with the effect of a short-notice at will termination clause in determining whether the taxpayer had an economic interest. In *Parsons,* at 225, the Court set forth seven factors which were indicia of an economic interest:

> To recapitulate, the asserted fiction is opposed to the facts (1) that petitioners' investments were in their equipment, all of which was movable — not in the coal in place; (2) that their investments in equipment were recoverable through depreciation — not

depletion; (3) that the contracts were completely terminable without cause on short notice; (4) that the landowners did not agree to surrender and did not actually surrender to petitioners any capital interest in the coal in place; (5) that the coal at all times, even after it was mined, belonged entirely to the landowners, and that petitioners could not sell or keep any of it but were required to deliver all that they mined to the landowners; (6) that petitioners were not to have any part of the proceeds of the sale of the coal, but, on the contrary, they were to be paid a fixed sum for each ton mined and delivered, which was, as stated in Huss, agreed to be in "full compensation for the full performance of all work and for the furnishing of all [labor] and equipment required for the work;" and (7) that petitioners, thus, agreed to look only to the landowners for all sums to become due them under their contracts.

The *Parsons* Court held that the taxpayer there met not one of these factors and thus did not have an economic interest in the coal in place. Unlike respondent here, Parsons was primarily a road building contractor and wanted to return to roadbuilding should an opportunity open up; hence, the termination clause. The agreement between Parsons and the owner of the coal was that Parsons would furnish its own equipment at its expense, as well as the facilities and labor to strip mine the coal, and then deliver the coal to the owner's cars. Parsons was to be paid a stated amount of money per ton by the owner, but Parsons was not permitted to keep or sell any of the coal on the open market. The agreement regarding termination was open-ended. As the Court noted at 217:

> [I]t was agreed that 'if Parsons or Rockhill wanted to quit, all that was necessary to terminate the arrangement was the giving of a ten day notice'

In the companion case of *Huss* v. *Smith,* 255 F.2nd 599, there was a written contract between the owner and Huss to strip mine certain coal. As in *Parsons,* Huss was to furnish at its own expense all the equipment, facilities and labor, was to deliver all coal mined to the owner who would pay Huss a stated sum per ton. As in *Parsons,* Huss was not permitted to sell the coal on the open market. There was a termination clause pursuant to which the owner/lessor at any time with thirty days written notice could terminate the arrangement without cause. The monies that were to be paid to both Parsons and Huss by the respective owners of the coal "was agreed to be in 'full compensation for the full performance of all work and for the furnishing of all material, labor, power, tools, machinery, implements and equipment required for the work.' " at 218.

In holding against the taxpayers in *Parsons,* this Court looked at all seven factors, found that the taxpayers failed them all, and concluded that the taxpayers involved were merely contract miners who had to look to the owners for payment for the work done and therefore bore no risk of the market and thus had no investment in the coal in place. Hence, said the Court, they were paid by the coal owners for their services in mining the coal for the owners rather than for their own benefit. The major distinguishing factor between the case at hand and *Parsons* is that the taxpayers in *Parsons* bore no risks of the market and therefore had no indicia of having made any kind of investment in the mineral in place to which they would have to look as an owner of such an interest to recover that investment. In the case at hand, it is clear that respondent bore all the risks of the market to recover its investment in the coal in place, as a lessee, and therefore had the kind of proprietary interest which has always been associated with

an economic interest. In any event, to the *Parsons* Court, the termination clause was only one of several factors to consider in determining whether the taxpayers had an economic interest so as to entitle them to the depletion deduction.

Winters Coal Company, Inc. v. *Commissioner,* 496 F.2d 995 (5th Cir. 1974), involved a lease very similar to the one in this case. The only issue was whether the termination clause in the lease was enough to deny the taxpayer the depletion allowance. In that case, the lease was automatically renewable every year, but each party had the right to give thirty days' notice of intent not to renew. Furthermore, either party had the right to terminate at will upon sixty days' notice (subsequently reduced to thirty days). The Court found, and the government has virtually conceded the same in the present litigation, that the lease conveyed to Winters Coal Company the rights to the coal in place. Therefore, the only question before the court was whether the termination clause by itself would destroy what was clearly otherwise an economic interest. The court then reviewed the *Parsons* criteria and determined with respect to the short notice termination clause the following at 1000:

> This being the only contra point to the vesting of an economic interest in the petitioner, to say that ABC had not passed an economic interest to Winters pursuant to the leases gallops beyond all reason and logic.

In *Bakertown Coal Company, Inc.* v. *United States,* 485 F.2d 633 (Ct. Cls. 1973), involving leases similar to the one in the present litigation, the Court of Claims indicated unmistakably its view that in dealing with the seven factors set forth in *Parsons* the terminability factor was only one of several to be considered in deter-

mining whether a taxpayer possessed an economic interest so as to entitle it to the depletion allowance. The Court said at 639:

> Though terminability was one of the seven disqualifying factors mentioned, it cannot be considered either in isolation or in the abstract, as the Government would have it. Rather, it is clear that in the context of the contractor-oriented opinion, coming in the wake of G.C.M. 26290 and the decisions that followed it, *the matter of terminability becomes only a colorably relevant factor where the applicant for the allowance lacks the traditional qualifications for depletion, as reflected by the other six conditions referenced by the court.* (Emphasis supplied)

The Court of Claims followed its reasoning in *Bakertown* in the judgment below clearly indicating it viewed the *Parsons* criteria as being a bundle of several different factors, none of which was necessarily controlling, and the terminability factor not even relevant if all other six factors were met. The government has conceded that all other six factors had been met. See the judgment below at 349.

In *Mullins* v. *Commissioner,* 48 T.C. 571 (1967), Judge Drennen in his dissent suggested that the terminability factor is not controlling but is an important factor to consider in determining whether a lessee holds an economic interest. He said with respect to the so-called Bolling lease at 584:

> I agree that the presence of a clause permitting the lessor to terminate the lease without cause on short notice is an important factor to be considered in determining who has the requisite economic interest in the coal under a lease or contract but I do not think it is conclusive, as does the majority [footnote omitted]. In my opinion we should look to the overall purpose of the depletion statute, and all the

> circumstances of the particular transaction, to determine how much weight to give to the termination clause in determining who had the economic interest in the deposit.

Judge Drennen's comments reflect the manner in which the Court of Claims and the Fifth Circuit have approached this problem. His opinion also expresses the generally accepted view of the resolution of tax disputes, namely, that such disposition should be based in economic reality and not in technical legal terms.

It is interesting to note that while this Court in *Parsons* did not regard the presence of terminability as controlling, neither did it regard the absence of terminability as controlling in *Paragon Jewel Coal Company, Inc.* v. *Commissioner,* 380 U.S. 624 (1965). Yet in both cases the percentage depletion deduction was denied to the contract miners involved. The denial was based, then, not on the presence or absence of a terminability clause but on the broader and controlling rationale that the contract miners did not have to look to the market place for a return of their investment. They looked only to the owners for a set return in exchange for the service of mining.

Since the government has conceded that respondent has met all the criteria set forth in *Parsons* except the one involving terminability and since the terminability issue is only significant if other indicia of an economic interest are absent, respondent is entitled to the percentage depletion deduction allowed by Sections 611(a) and 613 of the Internal Revenue Code, as amended.

II. Termination Clauses Of The Type In Question Here Do Not Invalidate An Otherwise Admittedly Legitimate Economic Interest Where The Taxpayer Clearly Has Acquired An Interest In The Minerals In Place Pursuant To A Lease, As Lessee, And Must Look To The Market To Recover Its Investment In The Minerals In Place

Pursuant to the lease between Preston County Coal and Coke and respondent, Preston County Coal and Coke leased to the leasee all of a certain tract of unmined coal and granted the lessee the exclusive right to mine that coal. The mining had to be performed in a good, workmanlike manner so as to mine and remove a maximum amount thereof consistent with modern mining methods. The lessee had to mine pursuant to existing rules and regulations of the United States and West Virginia and any which might be enacted after the effective date of the lease. The lessee also had to comply with all existing Workman's Compensation Laws and save the lessor harmless from any liability arising out of the operation of the mine. The lessee was to operate as an independent contractor. The term of the lease was for five years with an option in the lessee to renew for five years if the coal had not been removed by the end of the original term. The lessee was to pay the lessor a royalty of 25 cents per ton for the coal mined and removed. The parties agreed that upon written notice at least thirty days prior to the effective date of the termination, either party could cancel the lease without cause. The lease was assignable with the prior written consent of the lessor (J.A. 94a-96a).

By the terms of the lease, then, it is clear that the lessee respondent obtained a bona fide leasehold interest

in the coal in place and had to look to the open market to recover its investment in the coal in place. In other words, the lessee bore all the risks of ownership of the minerals in place as the only means by which it could recover its investment. It is precisely leases of this nature under which the lessee was really an entrepreneur, relying on the market to recover its investment as opposed to relying on the lessor for a fixed fee for services of mining, that led the Court of Claims in the instant case, as well as in *Thornberry Construction Co., Inc.* v. *United States,* 576 F.2d 346 (Ct. Cls. 1978), and *Bakertown Coal Co.* v. *United States,* supra, the Fifth Circuit in *Winters Coal Co.* v. *Commissioner,* supra, and Judge Drennen in his dissent in *Mullins* v. *Commissioner,* supra, to hold that an at will terminability clause would not destroy an otherwise valid economic interest so long as the leasehold interest clearly represented an investment in the minerals in place.

All but three of the cases holding that a termination clause of the type at issue here prevents the taxpayer from having an economic interest are distinguishable on their facts. In those cases the taxpayer involved had not an interest which required him to look to production and then sale of the minerals on the open market where he assumed all the risks of ownership to recover his investment. Rather, he was performing services for a set return per unit from the lessor or owner. The difference in those cases from the case at hand is that the taxpayers there were essentially performing services for monies to be paid from other than the open market as opposed to respondent who was an entrepreneur looking to recover its investment in the coal in place on the open market with all its attendant risks.

The only case which has presented this Court with an opportunity to pass on the question of the effect of short notice termination clauses has been *Parsons* v. *Smith,* supra. As noted above, in that case the taxpayer met none of the seven criteria set forth and therefore was denied the depletion allowance. In spite of the government's contention to the contrary at page 18 of its brief, *Paragon Jewel Coal Co.* v. *Commissioner,* supra, dealt only peripherally with the termination clause and based its holding squarely on the fact that the contractors there did not look to the market place for a return on their investment.

In *United States* v. *Stallard*, 273 F.2d 847 (4th Cir. 1959), while there was a thirty-day notice at will termination clause involved and it was held to be of some importance in denying the taxpayer/stripmining contractor the depletion allowance, the other most important factor involved was that the strip miner was only performing mining services because he did not depend on the market place for profit or loss but rather provided all the equipment and labor (very much as occurred in *Parsons* v. *Smith*, supra), mined the coal pursuant to the agreement, and then delivered it to the owner at a fixed price per ton. That is not the case with respect to respondent. Respondent was a bona fide lessee as opposed to a mining contractor, bore the risk of profit or loss of the open market, operated independently of the lessor, and was not subject to any control by the lessor. In short, respondent was not simply performing contract services for the lessor but was the owner of the coal under the lease and bore all the risks and responsibilities of an owner of such an interest.

In *McCall* v. *Commissioner*, 312 F.2d 699 (4th Cir. 1963), a thirty-day at will termination clause was involv-

ed and held to be the critical factor in denying the depletion allowance to the taxpayer. However, the terms of the agreement between the sublessor and the lessee/taxpayer required the lessee to mine the coal and deliver it to the sublessor at a set price per ton. Furthermore, in addition to the right in either party to terminate without cause after thirty days' notice, the sublessor had the right, if economic conditions prevented him from selling the coal mined and delivered by the mining contractor at a reasonable profit, to require the mining contractor to suspend operations upon twenty-four hours' notice. Also, the sublessor reserved the right to strip mine coal which could not be properly mined by the mining contractor through deep mining.

Those factors are not present in this case. Respondent was a bona fide lessee and had acquired all the rights exclusively, without interference or control by the lessor, to mine the coal it owned pursuant to the lease, bore the risks of the market as would any owner of a leasehold interest, and was free to sell to anyone at any price.

In *United States* v. *Wade*, 381 F.2d 345 (5th Cir. 1967), the contract miner there was paid a fixed amount for quarrying dolomite and delivering it to the lessor. He did not rely on the open market for his profit or loss. While the thirty-day notice at will termination clause was deemed to be important, it was not the only factor which caused the court to deny the depletion allowance. Rather, it was one of two major factors, the other one being the fact that Wade essentially provided a mining service.

In *Costantino* v. *Commissioner,* 445 F.2d 405 (3rd Cir. 1971), another thirty-day notice at will termination clause case was presented to the court. However, under

the arrangement between the mining contractor and the owner the mining contractor could look only to the owner for a set price per ton, thus evidencing the fact that the owner had not parted with any interest in the mineral in place but rather had contracted for the "lessee" to perform a mining service in extracting the mineral from the ground. This was one of several factors which caused the court, in addition to the thirty-day notice termination clause, to deny the depletion allowance to the taxpayer. Respondent, on the other hand, owned the leasehold interest, was not under control of the lessor, and bore all the risks of the market to recover its investment in the coal in place.

In *Holbrook* v. *Commissioner*, 65 T.C. 415 (1975), the Tax Court was faced with a thirty-day notice at will termination clause case. However, under the lease between the owner and the lessee/taxpayer title to the coal covered by the lease did not pass until the coal had been reduced to physical possession by the lessee. This factor alone had as much to do with the denial of the depletion allowance, if not more, than the thirty-day notice termination clause. Further, in *Holbrook* the mining right was not exclusive. These facts do not exist in the case at hand; thus *Holbrook* is easily distinguishable.

The three cases which appear to be directly in conflict with the judgment below may to some extent be distinguishable on their facts. However, for purposes of this argument, it is assumed that they are not distinguishable on their facts, at least insofar as the courts involved viewed the facts. The cases are *Weaver* v. *Commissioner*, 72 T.C. 594 (1979), *Mullins* v. *Commissioner*, supra, and *Whitmer* v. *Commissioner*, 443 F.2d 170 (3rd Cir. 1971).

The rational of those cases in holding that the presence of a thirty-day (or other short-term) notice termination clause at will defeats an economic interest is that the grantor or transferor has not really transferred any interest in the minerals in place because the transferee has no right to mine to exhaustion and therefore has no investment in the minerals in place which is the first requirement of *Palmer* v. *Bender*. *Palmer*, however, involved discovery depletion (287 U.S. at 554), which is no longer permitted. See Treas. Reg. Sec. 1.611-1(a)(1), Appendix, *infra*, at 3a. Both cost depletion and discovery depletion require an estimate of the amount of coal in place either at time of purchase or at time of discovery; then the depletion deduction is calculated on a per unit basis. See Treas. Reg. Sec. 1.611-2, *infra*, at 4a. In either case, it is necessary to estimate near the beginning of the mining operation how much coal is in the ground and then base the depletion deduction on that estimate. Where such a depletion method is used, it makes some sense to have a requirement that the person claiming the deduction be able to mine the deposit to exhaustion because the amount of the depletion deduction per unit is based implicitly on that assumption.

However, that is not the case with respect to percentage depletion which has absolutely nothing to do with an estimate of units of coal in the ground. And even though technically cost depletion should be calculated to determine if it exceeds percentage depletion (See Section 613(a) of the Internal Revenue Code of 1954, as amended), Appendix, *infra*, at 1a, as a practical matter this is not done by most taxpayers because of the inherent difficulty in making an estimate of the units which is one reason why Congress enacted percentage depletion.

Percentage depletion operates solely as a percentage of gross income generated through production and sale, and unlike cost depletion, is available to the taxpayer far beyond the time when the initial investment in the mineral has been recovered. See Section 613 of the Internal Revenue Code of 1954, as amended, *infra,* at 1a. Hence, there is no reason with respect to allowing percentage depletion that the person claiming the depletion deduction have the right to mine the deposit to exhaustion. In fact, so long as the person claiming the depletion deduction meets the general test of *Palmer* v. *Bender,* which is that the taxpayer has acquired legal control of a valuable economic interest from which he can realize gross income by exercising his mining rights, the depletion deduction should be available. That is the case with respect to respondent. Thus, in the three cases which appear to be contrary to respondent's position, the requirement of obtaining the right to mine to exhaustion with respect to percentage depletion is misplaced through a loose appliction of the *Palmer* v. *Bender* rule.

Furthermore, if a lease can be terminated for cause, that kind of termination does not destroy an otherwise valid economic interest. See *Whitmer* v. *Commissioner,* supra, and cases cited therein. Yet, if a lease is terminated for cause, nevertheless the lessee will not be able to mine the deposit to exhaustion. If that is true, then there is inconsistent treatment of those two situations unless the key is the fact that the transferor has retained control over the transferee by reason of having the short-notice termination power at will.

However, interpretations of the effect of termination clauses by the Internal Revenue Service indicates that short-notice at will termination clauses will destroy an otherwise valid economic interest, whether they are

exercisable by the transferor or a third party. In G.C.M. 26290, dealing with coal contract miners (as opposed to lessees) originally an at will termination clause for which a year's notice was required was thought to be of such a nature that it would not destroy an otherwise economic interest. An at will termination clause with notice of less than a year was thought to destroy an otherwise valid economic interest because the transferor was not conveying an interest which would permit the transferee to mine to exhaustion; therefore, the transferee had no investment in the mineral in place; therefore, the first requirement of the *Palmer* v. *Bender* rule had not been met. G.C.M. 26290, 1950-1 Cum. Bull. 42, declared obsolete in Rev. Rul. 70-277, 1970-1 Cum. Bull. 280. Strangely enough, though, in Rev. Rul. 77-481, 1977-2 Cum. Bull. 205, the Internal Revenue Service took the position that if the lease could be terminated by some one other than the grantor, there still was no economic interest because of the possibility that the deposit would not be mined to exhaustion by the lessee. The Internal Revenue Service itself, by taking this latter position, invalidates the only distinction to be drawn between termination for cause and termination at will. If the termination is for cause, the rationale for not having such a right destroy an otherwise valid economic interest is that there is no retention by the transferor of some power over the transferee. But, if the termination can be effected at the will of the transferor, then the transferor has retained so much control over the transferee that the transferee for all practical purposes has acquired no substantial interest.

In the instant case, as was pointed out in the judgment below, there is nothing in the record to indicate that the coal could not have been mined to exhaustion within the thirty-day period. In fact the Respondent has

mined to exhaustion all of the coal under the lease as of September 30, 1978. This is hardly a *Parsons* situation where there the contract was oral with a ten day notice of termination designed mostly because the 'lessee' Parsons wanted to be able to terminate the contract as soon as a road building project could be obtained.

Furthermore, in *Weaver, Mullins,* and *Whitmer,* just as with respect to the facts in the case at hand, the right to terminate on short-notice at will was merely a condition subsequent; and until that right was exercised, the lessee had every right, opportunity, and risk in carrying on his operation as a lessee under a lease without such a termination clause. *Bakertown Coal Co.* v. *United States,* supra; *Winters* v. *Commissioner,* supra; *Mullins* v. *Commissioner* (dissent), supra; judgment below at 350. In fact, respondent mined the coal to exhaustion without any exercise of the termination clause which is the focal point of this litigation.

By placing emphasis on the fact that certain lease arrangements are subject to short notice terminations, the Tax Court at least has put itself in a position of having to determine how long is short. Is thirty days short? Is a sixty-day period short? Is a one hundred twenty-day period short? See *Weaver* v. *Commissioner,* supra, for a situation where one hundred twenty days' notice was apparently adequate because on the facts with respect to that particular lease, one hundred twenty days was long enough for the lessee to mine the deposit to exhaustion. But what difference does it make whether a taxpayer who has a leasehold interest in the minerals in place and has to look to the market to recover his investment holds that lease subject to a short-term notice termination clause? For as long as he owns that leasehold, he

has all the right, title and interest to mine the coal and sell it to whomever he pleases. Under *Palmer,* that constitutes an economic interest although it may not last more than one day.

In summary there is no policy reason why under percentage depletion rules the lessee must have the right to mine the deposit to exhaustion. Certainly if the lessee has the right to mine the coal and depends upon the market for recovery of his investment and that right lasts only for one day, then at least for that one day he has borne all the risks of ownership in recovering his investment in the minerals by producing and selling on the open market. The lessee does not calculate his depletion based on estimates of units in the ground but, rather, by a percentage of income generated by the sale of the mined coal. The requirement of mining to exhaustion under percentage depletion is misplaced through a loose application of the *Palmer* v. *Bender* rule. The fact that there is a termination clause which is a condition subsequent to an otherwise valid economic interest ought not to affect that interest because until it is exercised, the lessee bears all the risks of ownership and must look to the production and sale of minerals in the open market place to recover his investment. That is all that *Palmer* v. *Bender,* supra, ever required. Here, the government has conceded that respondent has all indicia of an economic interest but for the termination clause. Until the termination clause is exercised (and it never was), the lessee has the exclusive right to mine and sell on the open market for his own benefit. That is an extremely valuable right until it is terminated.

III. Economic Reality Is The Touchstone In All Tax Cases

The termination clause at issue in fact was never exercised over the period during which respondent completely mined the coal under the lease. Quite clearly, then, the respondent had an interest in fact which permitted it to mine the coal to exhaustion. If and until the termination clause had been exercised, respondent had the requisite economic interest to permit its taking the depletion allowance.

In the judgment below at page 350, the Court of Claims stated that "the mere existence of the unused termination clause is not enough to deprive the taxpayer/lessees of their 'economc interest' they would otherwise have." This statement is based on the economic reality that until the termination clause is exercised, the lessee has every right to mine the coal and sell it on the open market, taking the risk of profit or loss upon itself and not looking to the lessor for payment which would amount simply to compensation for mining services rendered.

On page 351 of the judgment below, the court dealt again with economic substance and not technical form. The court looked to the records which "show that each of the taxpayers had regularly mined coal from the leases in question for a very substantial period prior to the taxable years [footnote omitted] and that, in all reality, they had a very good expectation of being able to continue to do so. In Nos. 403-75 and 400-77, we accept the showing that the lessors rarely (if ever) terminated without cause, not as demonstrating that the lessors lacked the legal power to terminate without cause [footnote omitted], but solely as showing that in practice and in reality the plaintiff coal-lessees had, at all rele-

vant times, a solid expectation that they could continue under their leases to mine the coal for a substantial period and to extract a substantial amount of the coal [footnote omitted]. This means — unless we are to depart from defendant's own norm for testing 'economic interest' by substance and reality, rather than by mere nomenclature or the theoretical form of the legal arrangement — that taxpayers are entitled to depletion. They satisfy the proffered criterion of knowing in advance that they will be able to mine for a substantial period and to extract a substantial portion of the coal. Certainly this was true at the beginning of each of the taxable years."

At 636 in *Bakertown Coal Co.*v. *United States,* supra, the court indicated its agreement that economic reality must be taken into consideration. It said:

> The property interest represented by that authority [that is, the authority over extraction and sale of minerals given pursuant to leases] is not varied or diminished simply because the authority is subject to the possibility of extinction in the future by a termination of the leases on short notice. The legal effect of a termination on these leases is no less prospective because the advanced notice requirement is only 30 days, than it would be if the specified period were one year.

Despite the government's argument to the contrary at pages 21-22 of its brief, as pointed out in the judgment below, there was no danger that, if the lessor could obtain a better royalty, the lessor would terminate the lease. Even though it is a fact that the market has increased substantially, no such action was ever taken because reality dictated that the lessor remain bound under the then existing lease. 602 F.2d 348 at 351 footnote 9.

Therefore, based on the reality existing in this case 1) that respondent mined the deposit to exhaustion without exercise of the termination clause by the lessor, 2) that the parties never had any intention of exercising that clause, 3) and that even though the price for coal has risen dramatically, the lessor never terminated the lease, the termination clause had no true economic significance in this case.

IV. The Lessor Has Not Claimed Any Depletion Allowance With Respect To The Coal Mined By The Lessee During The Tax Year In Question: Hence the Lessee Is Entitled To The Depletion Allowance Since Congress Did Not Intend That No One Be Able To Claim The Depletion Allowance.

If respondent is not entitled to the allowance for percentage depletion, there will be no depletion allowed on the coal mined under the lease. No claim for percentage depletion has been made by the lessor (Lindsley Deposition, page 9). The lessor did take capital gains on royalties under Section 631(c) of the Internal Revenue Code of 1954, as amended, (*id.*, 16).

The denial of percentage depletion to respondent where, as in this case, there are no other possible claimants, would bring about an untenable and inequitable result, clearly contrary to the intention of the Congress in enacting the "equitable apportionment" provision, Section 611(b)(1) of the Internal Revenue Code of 1954, as amended, *infra,* at 1a.

The deduction for percentage depletion is mandatory in all cases where it exceeds cost depletion, and it must be computed on the basis of an arbitrary percentage (in the case of coal, 10%) of the "gross income

from the property." Section 613 of the Internal Revenue Code of 1954, as amended. In 1951, Congress provided capital gains treatment for the recipients of coal royalties, in lieu of percentage depletion (Revenue Act of 1951, Section 325, P.L. 183, 65 Stat. 452, 501-2, the predecessor of Section 631(c) of the Internal Revenue Code of 1954).

Ever since that time, only lessees of coal lands and others similarly situated — i.e., those who have acquired an "economic interest" through arrangements other than leases — are entitled to any amount of percentage depletion. Both Section 631(c) of the Internal Revenue Code of 1954, as amended, Appendix, *infra*, at 2a, and Treas. Reg. Sec. 1.611-1(b)(2), Appendix, *infra*, at 4a, clearly specify that coal lessors and sublessors not actively engaged in the mining or preparation of coal are entitled to capital gains treatment instead of percentage depletion.

It is not within the province of the Commissioner, contrary to the statutory provisions above cited which are clear on their face, to completely eliminate depletion on a portion of the gross income from the coal property — that is, on the difference between the selling price of the coal and the royalty paid by the lessee to the lessor — as he has attempted to do in this case.

In *Paragon Jewel Coal Company, Inc.* v. *Commissioner,* supra, at 636-7, this Court thoroughly considered the provisions of Section 631(c) of the Internal Revenue Code of 1954, as amended, Appendix, *infra*, at 2a, and clearly indicated that "an owner who by contract disposes of the coal in place while retaining an economic interest is relegated to capital gains treatment of the royalties received," unless he is actively engaged in the mining of coal, in which case he is entitled to percentage

depletion. By no possible interpretation of the statutory provisions could the lessor in the instant case be considered to be within the "exemptive language in Section 631(c)," referred to by the Court in *Paragon* so as to be entitled to any portion of the percentage depletion allowance on the coal mined from the leases.

CONCLUSION

The judgment of the United States Court of Claims should be affirmed

Respectfully Submitted,

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Bull Run Mining Co.,
Inc.

September 19, 1980

APPENDIX

APPENDIX

Internal Revenue Code of 1954, as amended (26 U.S.C.):

Sec. 611. Allowance of Deduction for Depletion

(a) *General Rule* — In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance in all cases to be made under regulations prescribed by Secretary. For purposes of this part, the term "mines" includes deposits of waste or residue, the extraction of ores or minerals from which is treaded as mining under section 613(c). In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this section for subsequent taxable years shall be based on such revised estimate.

(b) *Special Rules*

(1) *Leases* — In the case of a lease, the deduction section shall be equitably apportioned between the lessor and the lessee.

Sec. 613. Percentage Depletion

(a) *General Rule* — In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 *shall* be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). For purposes of the preceding sentence, the allowable deductions taken into account with respect to expenses of mining in computing the tax-

able income from the property shall be decreased by an amount equal to so much of any gain which (1) is treated under section 1245 (relating to gain from disposition of certain depreciable property) as ordinary income, and (2) is properly allocable to the property. In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

Sec. 631. Gain or Loss in the Case of Timber, Coal or Domestic Iron Ore.

(c) *Disposal of Coal or Domestic Iron Ore With a Retained Economic Interest* — In the case of the disposal of coal (including lignite), or iron ore mined in the United States, held for more than 6 months before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal or iron ore, the difference between the amount realized from the disposal of such coal or iron ore and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272 shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal or iron ore. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal or iron ore. This subsection shall not apply to income realized by any owner as a co-adventurer, partner, or principal in the mining of such coal or iron ore, and the word "owner" means any person who owns an economic interest in coal or iron ore in place, including a sublessor. The date of disposal of such coal or iron ore shall be deemed to be the date such coal or iron ore is mined. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and

royalties shall be determined without regard to the provisions of this subsection.

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§1.611-1. Allowance of Deduction for Depletion.

(a) *Depletion of mines, oil and gas wells, other natural deposits, and timer* — (1) *In general.* Section 611 provides that there shall be allowed as a deduction in computing taxable income in the case of mines, oil, and gas wells, other natural deposits, and timber, a reasonable allowance for depletion. In the case of standing timber, the depletion allowance shall be computed solely upon the adjusted basis of the property. In the case of other exhaustible natural resources the allowance for depletion basis of the property (see section 612, relating to coast depletion) or upon a percentage of gross income from the property (see section 613, relating to percentage depletion), whichever results in the greater allowance for depletion for any taxable year. In no case will depletion based upon discovery value be allowed.

(b) *Economic interest.* (1) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the xtraction of the mineral or severance of the timber, to which he must look for a return of his capital. For an exception in the case of certain mineral production payments, see section 636 and the regulations thereunder. A person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because through a contractual relation he possesses a mere economic or pecuniary advantage derived from production. For example, an agreement between the owner

of an economic interest and another entitling the latter to purchase or process the product upon production or entitling the latter to compensation for extraction or cutting does not convey a depletable economic interest. Further, depletion deductions with respect to an economic interest of a corporation are allowed to the corporation and not to its shareholders.

(2) No depletion deduction shall be allowed the owner with respect to any timber, coal, or domestic iron ore that such owner has disposed of under any form of contract by virtue of which he retains an economic interest in such timber, coal, or domestic iron ore, if such disposal is considered a sale of timber, coal, or domestic iron ore under section 631(b) or (c).

Supreme Court, U. S.
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No. 79-1515

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

UNITED STATES OF AMERICA, *Petitioner,*

v.

ELWOOD SWANK AND RITA SWANK, *Respondents.*

UNITED STATES OF AMERICA, *Petitioner,*

v.

BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA, *Petitioner,*

v.

BULL RUN MINING CO., INC.

On Writ Of Certiorari To The United States Court Of Claims

BRIEF OF ELWOOD SWANK AND RITA SWANK

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QUESTION PRESENTED

Did the United States Court of Claims err in holding that Elwood Swank, as lessee, possessed an economic interest in certain coal in place under coal mining leases with Northumberland County, as lessor, which were not terminated during the years in suit, thereby permitting him to deduct allowance for percentage depletion of coal under Sections 611 and 613 of the Internal Revenue Code of 1954, as amended?

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BULL RUN MINING CO., INC.

On Writ Of Certiorari To The United States Court Of Claims

BRIEF OF ELWOOD SWANK AND RITA SWANK

STATEMENT OF THE CASE

The termination clauses in the leases involved in this case were never exercised.

Pursuant to a deep mining lease dated October 24, 1964, Swank,[1] as lessee, deep mined anthracite coal

---

[1] References to Swank are to Respondent Elwood Swank. Rita Swank is a party solely because she filed joint federal income tax returns with her husband during the years in suit.

from 1964 through 1967. Pursuant to a stripping lease dated July 25, 1966, Swank, as lessee, strip mined anthracite coal during 1966 and 1967. The lessor under these mining leases was Northumberland County. The lessor never terminated the leases. Swank's successor, Split Vein Coal Company, Inc.,[2] is still mining pursuant to the stripping lease. The 1964 deep mining lease was abandoned in May 1968 because of a mountain slide caused by heavy rains which closed the deep mine, thereby preventing further mining of the mine by anyone. Swank and his successor, Split Vein Coal Company, Inc., deep mined coal under the deep mining lease until the mountain slide closed the mine (J.A. 51a-52a).

Swank purchased the October 24, 1964 deep mining lease, and the mining operation thereunder, from Edward Gusick who owned and mined under the lease before Swank. The purchase price was $12,085, which allocated as follows: $5,085 for generating equipment and $7,000 for Gusick's existing excavation and mine (J.A. 52a, 55a).[3]

Swank did not negotiate or prepare the leases. He could not do so. These leases were on standard forms prepared and used by the County of Northumberland. The leases were not subject to negotiation. Nor-

---

[2] During 1966 and the first four months of 1967, Swank was a sole proprietorship. On May 1, 1967, the assets of the sole proprietorship were transferred to Split Vein Coal Company, Inc., in a tax-free incorporation pursuant to Section 351 of the Internal Revenue Code of 1954, as amended.

[3] The government contended before the Court of Claims that only $1,000 of the purchase price was capitalized into an account covering purchased excavations. However, the Learned Trial Judge and the Court of Claims rejected this contention (J.A. 52a; 602 F.2d at 350, 352), finding that Swank purchased the excavation for $7,000.

thumberland County never sold a fee simple interest in coal lands for fear of criticism over selling such land if valuable minerals were discovered subsequent to sale. The Northumberland County Commissioners told Swank that Northumberland County would not terminate his leases except for cause. The commissioners also announced this policy not to terminate mining leases except for cause in public meetings and in the press. Every lessee of county coal lands received the same form lease from the county and in each case it was with the stipulation that the county would not terminate except for cause. The reason for this policy was that the County Commissioners recognized that they could not expect a lessee of county coal land, like Swank, to invest time and considerable capital in the development of county coal lands without some assurance that, if he conformed to the terms of the lease, he would be allowed to recover his investment and make a profit on his mine (J.A. 53a-55a).

The Northumberland County Commissioners terminated mining leases only for cause, which meant:

(1) Failure to pay the royalties; or

(2) Failure to pay the correct amount of royalties; or

(3) Failure to make the mine productive (J.A. 54a).

The Swank leases contain no express language permitting Northumberland County to terminate the leases "without cause". The words "without cause" are not in the leases (J.A. 22a-48a).

Swank was under no obligation to sell the coal to Northumberland County or any other party or person. He sold the coal to whomever he pleased at whatever price he could obtain. Swank sold no coal to Northumberland County (J.A. 54a).

The income which Swank received from his mining operations was solely derived from, and tied to, his extraction and sale of coal during the tax years involved. Swank looked solely to the extraction of coal for a return of his investment (J.A. 52a-55a). Swank was not a mining contractor. He was a coal miner mining coal as a lessee under valid coal leases (J.A. 51a, 55a).

Swank's investment in the coal in place was substantial. Swank invested more than $225,000 in strip mining and deep mining equipment. He purchased and improved a tipple, or breaker, at a cost of $118,477.27; constructed a railroad siding at a cost of $10,000; and built access roads to his strip mine from public highways at a cost of $6,500. In addition, during 1966 and 1967, Swank's payroll consisted of 14 employees, and he paid Northumberland County royalties of $7,545.10 in 1966 and $6,854.05 in 1967 (J.A. 53a, 55a-56a).

SUMMARY OF ARGUMENT

By his leases with Northumberland County, Swank acquired an economic interest in the coal in place. In order to mine, process and market the coal conveyed to Swank under the leases, Swank invested more than $325,000 to purchase mining machinery and equipment, to purchase and improve a tipple, to purchase a railroad siding and also to build roads for access to public highways from his strip mine. Swank owned the coal he extracted under the leases. He sold it to whomever he wanted at the best price he could obtain. Swank looked not to the lessor but to the extraction and sale of the coal for return on his investment and profit. Therefore, Swank satisfied the requirements of the economic interest test established by this Court in *Palmer* v. *Bender*, 287 U.S. 551 (1933) and adopted almost *verbatim* by Petitioner in its Treasury Regulations. Treas. Reg. 1-611-1(b)(1).

Swank had an economic interest in the coal in place without regard to the term of the leases. Swank's leases were not terminated. Northumberland County, the lessor, agreed not to terminate the leases and did not do so. During the tax years in question, Swank mined continuously under the leases. Petitioner ignores this reality.

Terminability is not an issue. Petitioner's argument is based upon the possibility that the leases might have been terminated. Terminability is only one of seven criteria, applicable only to mining contractors, not lessees like Swank. These seven criteria are used only in mining contractor cases to determine whether mining contractors qualify for percentage depletion. Unlike mining contractors, Swank by his leases with Northumberland County acquired the right to mine the coal and to convert the mined coal to his own use. This right, coupled with his investment and his looking to extraction and sale of the coal, and not to the lessor, for a return of his investment and profit, differentiates Swank and other lessees of coal property from mining contractors. *Paragon Jewel Coal Co.* v. *Commissioner,* 380 U.S. 624 (1965).

Only Swank is entitled to percentage depletion and if denied this Congressional entitlement, no other person, including lessor, will be entitled to percentage depletion with respect to coal mined by Swank. The lessor is relegated to capital gains treatment on the rents or royalties received from the lessee and must use cost depletion in computing the capital gains. The lessee deducts the percentage depletion allowance from ordinary income derived from the sale of coal mined under the leases, excluding rents and royalties paid to the lessor. Petitioner confuses percentage depletion and cost depletion. Percentage depletion, not cost depletion, is involved in this case.

ARGUMENT

Swank Acquired An Economic Interest In The Coal In Place Mined Under His Coal Mining Leases With Northumberland County, And Is Entitled To Percentage Depletion Deduction For Such Coal

A. Swank possessed an economic interest in the coal in place

A prerequisite to the allowance of the percentage deduction is the existence in the claiming taxpayer of an economic interest in the coal in place, the definition of which interest was first described in *Palmer* v. *Bender,* 287 U.S. 551 (1933), and later incorporated almost *verbatim* into Treasury Regulation §1.611-1(b)(1), which provides in pertinent part as follows:

> "An economic interest is possessed in every case in which the taxpayer has acquired by investment *any* interest in mineral in place or standing timber and secures, by *any form* of legal relationship, income derived from the extraction of the mineral or severance of the timber, to which he must look for a return of his capital."(Emphasis added)

Accord, 287 U.S. at 557; *Parsons* v. *Smith,* 359 U.S. 215, 221 (1959).

This regulation defines the elements of an economic interest, and also describes the exact nature of Swank's interest in the coal under his leases with Northumberland County. These elements are as follows:

> (1) An acquisition of any interest in mineral in place by any form of legal relationship,
>
> (2) By investment, and
>
> (3) The securing of income derived from the extraction of the mineral and to which the taxpayer must look for a return of his capital.

1. The acquisition of any interest in mineral in place by any form of legal relationship

The 1964 deep mining lease and the 1966 stripping lease were entered into by Northumberland County, as lessor, and Swank, as lessee. The deep mining lease granted Swank "the right and privilege of digging and mining anthracite coal wholly at his own expense and cost" from the Jeremiah Jackson tract of land and the Fulton Lands in Northumberland County (J.A. 23a). The 1966 stripping lease granted Swank the "right to have, convey and transport the raw coal stripped from the said premises over, through and across the . . . premises", at "his own expense and cost" (J.A. 42a-43a).

There is no contention that these leases were not valid and binding upon the parties thereto during the tax years in question. Where there is a valid and binding lease of coal, there is a sufficient "form of legal relationship". *Palmer* v. *Bender, supra.* The economic interest of the lessee exists independently of the lessor's legal title to the mineral in place. *Lynch* v. *Alworth-Stephens Co.,* 267 U.S. 364 (1925), wherein the Court ruled:

> "It is, of course, true that the leases here under review did not convey title to the unextracted ore deposits *(United States* v. *Biwabik Mining Co.,)* 247 U.S. 116, 123, 38 S. Ct. 462, 62 L. Ed. 1017); but it is equally true that such leases, conferring upon the lessee the exclusive possession of the deposits and the valuable right of removing and reducing the ore to ownership, created a very real and substantial interest therein. See *Hyatt* v. *Vincennes Bank,* 113 U.S. 408, 416, S. Ct. 573, 28 L. Ed. 1009; *Ewert* v. *Robinson,* 10 Cir., 289 F. 740, 746-750. And there can be no doubt that such an interest is property. *Hamilton* v. *Rathbone,* 175 U.S. 414,

421, 20 S. Ct. 155, 44 L. Ed. 219; *Bryan* v. *Kennett,* 113 U.S. 179, 192, 5 S. Ct. 407, 28 L. Ed. 908.

* * *

"There is nothing to suggest that the word 'property' is used in any restricted sense. In the case of mines, a specific kind of property, the exhaustion is described as depletion,. . .The interest of respondent under its leases in the mines being property, its right to deduct a reasonable allowance for exhaustion of such property, if there be any, during the taxable year results from the plain terms of the statute, such deduction, since the property is an interest in mines, to be limited to the amount of the exhaustion of respondent's interest caused by the depletion of the mines during the taxable year.

* * *

It is said that the depletion allowance applies to the physical exhaustion of the ore deposits, and since the title thereto is in the lessor, he alone is entitled to make the deduction. But the fallacy in the syllogism is plain. The deduction for depletion in the case of mines is a special application of the general rule of the statute allowing a deduction for exhaustion of property. While respondent [a lessee] does not own the ore deposits, its right to mine and remove the ore and reduce it to possession and ownership is property within the meaning of the general provision." 267 U.S. at 369-370.

Similarly, in *Commissioner* v. *Southwest Exploration Co.,* 350 U.S. 308 (1956), the Court recognized "that the law of depletion requires an economic rather than a legal interest in the oil [mineral] in place". 350 U.S. at 316.

In *Anderson* v. *Helvering,* 310 U.S. 404 (1940), the Court discussed the requirements of the "form of legal relationship." The Court noted that, in *Thomas* v.

Perkins, 301 U.S. 655 (1937), a provision in an oil lease for payments solely out of oil production was equivalent to a reservation from the granting clause of an amount of oil to the grantor, and should be given the same tax consequences as a provision for oil royalties. Citing *Palmer* v. *Bender, supra,* the Court stated that the *Perkins* decision, "did not turn upon the particular instrument involved, or upon the formalities of the conveyancer's art, but rested upon the practical consequences of the provision for payments of that type." 310 U.S. at 411. The lessee's right under his lease to convert the lessor's legal title to minerals in place to his own possession by their severence constitutes a very real and substantial economic interest in the mineral in place which depletes as the minerals are extracted. *Lynch* v. *Alworth-Stephens Co.,* 267 U.S. at 369; *Swank* v. *United States,* _____Ct. Cl. _____, 602 F.2d 348, 353-354 (1979); *Bakertown Coal Company, Inc. et al.* v. *United States,* 202 Ct. Cl. 842, 485 F.2d 633 (1973).

Under Pennsylvania law, a lease of coal lands constitutes a sale of the coal by the lessor to the lessee. *Shenandoah Borough* v. *Philadelphia,* 367 Pa. 180, 79 A.2d 433 (1951), wherein the Pennsylvania Supreme Court emphasized:

> "To a great many people who do not live in coal counties, the aforesaid instrument having the usual terms and attributes of a lease, would seem to be a lease. Nevertheless, the law is long and well settled in Pennsylvania that ' "The grant of a right to mine coal in the lands of the lessor and remove it therefrom, although the instrument may be called a lease, is a grant of an interest in the land itself, and not a mere license to take the coal." The transaction. . . constituted a sale of the coal conditioned upon its being removed within the period specified':

> *Lazarus's Estate,* 145 Pa. 1, 8, 23 A.372." 367 Pa. at 186, 79 A.2d at 436.

Therefore, there is no question that, as a matter of law, a substantial ownership interest in the coal was vested in Swank under his leases with Northumberland County. *Palmer* v. *Bender, supra; Lynch* v. *Alworth-Stpehens Co., supra.*

2. By Investment

In *Commissioner* v. *Southwest Exploration Co., supra,* the Court explained the investment requirement:

> "An allowance for depletion has been recognized in our revenue laws since 1913. It is based on the theory that the extraction of minerals gradually exhausts the capital in vestment in the mineral deposit. Presently, the depletion allowance is a fixed percentage of gross income which Congress allows to be excluded; this exclusion is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired. *The present allowance, however, bears little relationship to the capital investment, and the taxpayer is not limited to a recoupment on his original investment. The allowance continues so long as minerals are extracted, and even though no money was actually invested in the deposit.* The depletion allowance in the Internal Revenue Code of 1939 [the forerunner of the present statute] is *solely* a matter of *Congressional grace; . . .*" 350 U.S. at 312 (Emphasis added).

Accord, *Paragon Jewel Coal Co.* v. *Commissioner et al.,* 380 U.S. 624 (1965); *Charles P. Mullins* v. *Commissioner,* 48 T. C. 571, 579-580 (1967) (two leases held to confer economic interest in lessee despite lessee's not investing any money in the coal deposit).

Paragon Jewel involved a dispute over entitlement to coal depletion allowance between lessee under an assignment of coal leases and the mining contractors hired by the lessee to mine the coal. The Court held that Paragon Jewel, the lessee, was entitled to the depletion allowance, finding the following purchases by Paragon Jewel to be an investment within the meaning of Treasury Regulation 1.611-1(b)(1):

> "It [Paragon Jewel, the lessor] made substantial investments in preparation for processing and marketing the coal, including construction of a tipple, a power line, a railroad siding with four spurs and the purchase of processing equipment. It also built a road from the tipple which circled the mountain close to the outcrop line of coal. This road was used to truck coal from the contractors' mines to Paragon's tipple." 380 U.S. at 628.

Similarly, in order to mine under the leases and to process and to market the coal, Swank purchased machinery and equipment at a cost exceeding $225,000 (J.A. 56a) and constructed roads at the strip mine as access to public highways for a total cost of $6,500 (J.A. 55a). Swank also maintained, at his expense, his own breaker, or tipple, which is a plant required to clean and to process the coal. In 1959, he purchased the tipple for $22,000. Between 1959 and 1966 he spent $96,477.27 to make improvements to the tipple, which were necessary to make it operable. Swank operated this tipple during the tax years in question (J.A. 56A). In 1962 or 1963, he purchased for $10,000 a 600-foot railroad siding located 1,000 feet from his tipple. The siding was connected to the Penn Central rail line and, during the years in suit, was used to transport coal to the public after its sale from Swank's tipple. He leased the land where the siding was located in 1966 and 1967 for $600 per year (J.A. 56a). Swank also purchased two leases and in-

dependent mining operations for $19,085. These purchases included slopes or excavations several hundred feet deep and also certain mining equipment in the mines (generator, hoist, pump compressor, rails for access by buggie to the mines) (J.A. 52a). Swank paid Northumberland County $14,339.15 in royalties under the leases during 1966 and 1967 (J.A. 53e). As a matter of law, these expenditures constitute an investment sufficient to establish Swank's economic interest in the coal in place. *Commissioner* v. *Southwest Exploration Co., supra; Paragon Jewel, supra; Thornberry Construction Co., Inc.*, 217 Ct. Cl. 196, 576 F.2d 346 (1978); *Bakertown, supra; National Steel Corporation* v. *U.S.*, 176 Ct. Cl. 952, 364 F.2d 375 (1966).

Another factor militates in Swank's favor. Northumberland County, a municipal government, neither claimed nor needed to claim the depletion allowance at bar. Unless Swank prevails, no one will be entitled to and no one will receice percentage depletion allowance on the coal removed from the land under the leases during the years at issue. Congress clearly did not intend this result, as the Court noted in *Lynch* v. *Alworth-Stephens Co.* and *Parsons* v. *Smith, supra.* Accord, *Bakertown, supra.*

3. The securing of income derived from the extraction of the mineral and to which Swank must look for a return of his capital.

That income was derived from Swank's coal mining operation under the leases is not disputed. The critical point is that such income resulted solely from porfits realized by the sale of the coal in the market place. Swank owned the coal which he removed. He was under no obligation to sell the coal to lessor or anyone else.

He could sell the coal to whomever he pleased at whatever price he could obtain. He did so (J.A. 54a). There is no provision in either lease for any payment by the lessor to the lessee which would indicate any agency relationship. (J.A. 22a-48a). Petitioner does not dispute these facts.

Any income accruing to Swank was as a result of the dissipation or depletion of coal owned by him, and the offsetting depletion allowance should rightfully be available to him. Swank, as lessee, was mining coal for sale to a third party, not lessor, at an independently determined price, and was required to look to the extraction of that coal and the sale thereof for a return on his investment and profit. The income and extraction element of Treasury Regulation 1.611-1(b)(1) and *Palmer* v. *Bender, supra,* is, therefore, satisfied.

B. Swank had an economic interest in the coal in place without regard to the term of the leases.

1. The Swank leases were not terminated. The lessor agreed not to terminate the leases except for cause.

Petitioner based its disallowance of Swank's depletion deduction on its contention that the printed lease forms required by Northumberland County entitled the lessor to terminate the lease without cause on thirty-day's notice.[4] The gravamen of Petitioner's argument is the *possibility* that the leases might have been terminated. With respect to depletion, the tax law deals in economic realities, and not in possibilities or bare legal abstractions or fictions. *Southwest Exploration, supra,* 350 U.S. at 315; *National Steel, supra,* 176 Ct.

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[4] Petitioner's Brief at 16-23.

Cl. at 967, 364 F.2d at 383. The *reality* at bar is that, during the tax years in question, the leases were not terminated and that, pursuant to the leases, Swank mined coal during the tax years in question (J.A. 52a-54a). Swank's successor, Split Vein Coal Company, Inc., is still strip mining under the July 25, 1966 strip mining lease.

In *Southwest Exploration,* the Court was required to determine whether the upland land owners or the drilling contractor was entitled to the oil depletion allowance. The land of the upland property owners was indispensable to the drilling. The drilling contractor, Southwest, argued that drilling approaches which it might have used in compliance with California law qualified it for the oil depletion allowance. In rejecting this argument, the Court emphasized:

> "State law required that the wells be drilled either on the uplands or on filled lands, and there were no filled lands available. By hindsight Southwest now suggests that it might have constructed a drilling island which might have been considered as filled land under the statute. Then, too, perhaps the State itself might have changed the law or condemned the uplands under existing law. But none of these possibilities occurred." 350 U.S. at 315-316.

The Court based its decision in *Southwest Exploration* on the facts which actually occurred, not on speculation about unrealized possibilities.

The termination provisions of Northumberland County coal leases were unusual. Despite the termination provisions, the County Commissioners, since 1956, promised Swank and the other Northumberland County miners that the leases would be terminated only for cause (J.A. 54a-55a). Cause was defined as: (1) failure to pay the royalty; (2) cheating the lessor on the amount

of the royalty; or (3) failure to mine for an unreasonable period of time. Swank discussed these causes and the termination provision with the County Commissioners before signing the leases (J.A. 54a-55a). The County Commissioners recognized that they could not expect Swank or any other miner to invest time and considerable capital in development of mines under the leases without assurance that, if he conformed to the terms of the lease, he would be allowed to recover his investment and make a profit on his mines (J.A. 54a). The termination provisions of the leases contained no reference to the words" without cause" (J.A. 22a-48a).

The leases were standard forms with "boilerplate" clauses prepared by the County of Northumberland, not Swank, and were not subject to negotiation (J.A. 53a-54a). Swank, if he wished to mine in the Shamokin area where he lived, was required to sign the leases with only the oral stipulation that the leasees would not be terminated except for cause. Every miner received the same lease form (J.A. 54a). Consequently, Swank did not enter into the leases in an arms-length, fully negotiated transaction. He had no alternative! The Court of Claims described such leases as " 'administered' leases" (J.A. 53a-54a).

The Northumberland County Commissioners would not enter into leases without a 30-day termination clause, in order to avoid allegations of political favoritism in granting long-term coal leases to friends or criticism by the public in leasing county coal lands. This policy was publicly announced in Northumberland County since 1956. The Northumberland County Commissioners never sold a fee simple interest in the coal lands in order to avoid criticism over selling such lands if valuable, extensive coal deposits were discovered and

exploited by the purchaser after the sale (J.A. 53a). Instead, Nortnumberland County, as lessor, acting through its Commissioners, collected coal royalties from the lessee-independent coal miners who mined these coal lands. The royalties were used to finance Northumberland County government, without the County's having to become engaged in coal mining. The county's objective was to keep the lessees' mines actively producing and to collect royalties from the lessees' coal mining operations without having to engage in coal mining and without disposing of the valuable coal lands purchased at tax sales (J.A. 53a-54a).

Undoubtedly, any miner dealing with the County would like to have a long-term lease. A miner dealing with a private owner of coal-bearing land might well negotiate a long-term lease before proceeding. But independent miners take what the County will give where the County has a virtual monopoly on coal-bearing land. Northumberland County will not sell land, and its standard lease must be accepted by all who wish to mine on county land.

Northumberland County is located in the heart of the anthracite deposits in the United States. These deposits are concentrated in north central Pennsylvania. During 1966 and 1967, the County owned more than 17,500 acres of anthracite coal land which it leased to miners like Swank under leases identical to Swank's leases (J.A. 52a, 54a). By depriving Swank the percentage depletion allowance for coal mined under the leases, the Court establishes precedent denying percentage depletion for coal mined throughout Northumberland County — a significant portion of the nation's anthracite deposits. This result violates Congressional policy underlying the percentage depletion

allowance — because mineral deposits are wasting assets, the percentage depletion is available to the owner of an economic interest therein so long as the minerals are extracted even though no money is invested in the deposits. This policy is based upon Congress' legislative grace. *Palmer* v. *Bender, supra; Southwest Exploration, supra.*

2. Terminability is not an issue

Petitioner's entire argument is predicated on its misapprehension that seven factors, applicable only to mining contractors, are also applicable at bar. These seven factors were listed in *Parsons* v. *Smith, supra,* and *Paragon Jewel Coal Co.* v. *Commissioner, supra.* Your Honorable Court, the Fifth Circuit Court of Appeals and the Court of Claims expressly ruled that these factors apply *only to mining contractors. Paragon Jewel, supra; Winters Coal Co., Inc.* v. *Commissioner,* 462 F.2d 995 (5th Cir. 1974); *Bakertown, supra; Thornberry, supra.* Swank is *not* a mining contractor; Swank *is* a coal miner, a lessee of coal lands (J.A. 55a).

In *Parsons* and *Paragon,* the Court illustrated the distinction between lessees of coal lands and mere mining contractors. By the lease, the lessor surrenders to the lessee or sublessee part of the lessor's interest in the coal in place. Under the lease, the lessee, after severing the coal from the leasehold, owns the coal and sells the coal to whomever the lessee pleases at whatever price he can obtain. The lessee derives income from the sale of the coal, to which he must look for a return of his capital. In comparison, by his contract to mine, the mining contractor enjoys no interest in the coal after severence, which coal belongs to the lessee or landowner, and the mining contractor looks only to the

lessee or the landowner for payment of a fixed price per ton of coal mined under the contract. The *Paragon* Court explained the seven factors applicable to contract miners:

> "In *Parsons,* the Court enumerated seven factors to be considered in determining whether the *coal-mining contracts* there involved gave the *contract miners* any capital investment or economic interest in the coal in place" 380 U.S. at 633. (Emphasis added.)

In *Paragon,* which involved a dispute between a lessee and its mining contractor over percentage depletion allowance, the Court held that the lessee, Paragon, not the mining contractor hired by the lessee, qualified for the percentage depletion allowance, explaining:

> "Section 611(b) establishes an equitable apportionment of such allowance between the lessor and the lessee in the case of a lease. However, §611(b) must now be read in the light of §631(c) which provides that an owner who disposes of coal under any form of contract in which he retains an economic interest shall not receive percentage depletion, but instead must take capital gains treatment for the royalties received under that contract. The result of this in the typical lessor-lessee situation is that the lessee is entitled to the entire depletion allowance on the gross income from the property. Respondent contract miners make no contention that they are lessees or the sublessees of Paragon." 380 U.S. at 632-633.

Crucial to the *Paragon* Court's denying the contractor's claim for percentage depletion deduction was that they had not acquired an interest in the coal in place and had not secured income from the extraction of the coal. Instead, they had to look only to the lessee's covenant for payment of the agreed upon fee regardless of the market price at the time the coal was delivered. 380 U.S. at 635.

In *Parsons* and *Paragon*, the Court applied the seven factors to contract miners only, not to lessees under coal leases. Throughout its brief,[5] Petitioner, erroneously, uses the terms "lessee" and "mining contractor" as synonyms. The *Parsons* and *Paragon* Courts distinguished between the terms, applying the seven factors only to mining contractors. Consequently, terminability, only one of the seven factors, is inapplicable to coal leases and the economic interests of lessees in the coal in place described therein.

The *Bakertown* Court similarly concluded:

> ". . . [I]n view of the Government's total preoccupation with the matter of terminability, we think its position in this case is the product of confusion in the economic interest area of depletion. In our view, the entire defense herein rests on a misapplication of basic principle.
>
> "It seems to us that the Government is here attempting to remove transactions from the traditional ambit of economic interest by resort to a principle [the seven factors applicable to mining contractors only as announced in *Parsons, supra*] that it sponsored to liberalize and expand that established concept to encompass transactions not therefore within it. The erroneous transposition is as between lessees, persons who have acquired the right to remove and retain mineral underlying the leased premises, and mining contractors who, although functionally involved in the production of salable mineral (and therefore financially interested in the life of the deposlt as a source of continuing need for their services), have no effective authority over production and acquire no ownership of the extracted mineral. 202 Ct.Cl. at 848, 485 F.2d at 636.

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[5] Petitioner's brief at 16-23.

* * *

"In sum, it appears that the pertinence of the terminability factor [*one* of the seven factors] as advanced by the Treasury, was as a device for enlarging the concept of economic interest in order to afford strip miners, who had no fee or leasehold interest, the benefits of depletion deductions to offset the income that they earned in the form of fees for their extraction services. 202 Ct.Cl. at 851, 485 F.2d 638.

In 1950, the Treasury Department created terminability as a device to enlarge the economic interest concept to afford contractors, who, unlike Swank, lacked a fee or leasehold interest, the benefits of percentage depletion deduction. Research reveals that, before 1950, the United States Supreme Court never found a taxpayer to have a depletion interest in a mineral deposit without a fee or leasehold interest in that deposit.[6] For this reason, the Treasury Department compromised to benefit mining contractors, promulgating G.C.M. 26290 (1950-1 Cum. Bull. 42).[7] *Bakertown, supra.* G.C.M. 26290 listed terminability as *one* of *seven* criteria to consider in determining the availability of the depletion allowance for *contractors.* Terminability is not the only such criterion. *Parsons v. Smith, supra; Paragon Jewel*

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[6] Research also reveals that, since then, the United States Supreme Court only once held that a taxpayer without a fee or leasehold interest in the deposit was entitled to depletion. *Southwest Exploration, supra* (1956) (Upland property owners were found to have an economic interest in offshore oil deposits extracted by slant drilling because the use of their property was physically and legally indispensable to the extraction process.)

[7] In 1956, Treasury extended depletion allowance to a mining company's shareholders for mineral deposits owned by the company. Rev. Rul. 56-542, 1956-2 Cum. Bull. 327. See, *National Steel Corp.* v. *United States, supra.*

Coal Co. v. *Commissioner, supra.* These cases and the other cases on which Petitioner relies, improperly, are mining contractor cases. Swank was a coal miner with leasehold interests pursuant to which he mined in 1966 and 1967, the years in suit. The leases were not terminated during that time. Speculate as it will, Petitioner cannot escape these facts. In *Bakertown,* the Court of Claims stressed the defects in Petitioner's argument:

> "Though terminability was one of the seven disqualifying factors mentioned, it cannot be considered either in isolation or in the abstract, as the Government would have it. Rather, it is clear that in the context of the contractor-oriented opinion coming in the wake of G.C.M. 26290 and the decisions that followed it, the matter of terminability becomes only a colorably relevant factor where the applicant for the allowance lacks the traditional qualifications for depletion, as reflected by the other six conditions referenced by the court.
>
> * * *
>
> "In the context of economic interest, terminability has been specifically considered by the Supreme Court only in the evaluation of depletion claims by mining contractors." 202 Ct.Cl at 853-854, 485 F.2d at 639-640.

By its express terms, G.C.M. 26290 referred *only* to *contractors.* G.C.M. 26290 created seven (7) criteria applicable only to contractors for the purpose of enabling contractors, who mined only for the benefit of landowner coal company-landowners or lessees for sums due them from removing the coal, to claim the percentage depletion allowance. If, in a particular case, the contractor qualifies for the depletion allowance, the landowner coal company or lessee cannot claim it. The contractors, unlike Swank, are not able to convert the

coal to their own use by severing or mining it. The contractor, unlike the lessee, owns no coal, even after severance. The landowner coal company or lessee owns all the coal mined by a contractor. At bar, when Swank mined the coal under the leases, he owned it; sold it to whomever he pleased at whatever price he wanted; never sold it to Northumberland County; and did not look to the County for any income from his mining the coal. Swank was entitled to receive and received all proceeds from the sale of the coal.

The Court of Claims explained Petitioner's misconception that terminability applies to lessees under mining leases:

> "The erroneous transposition is as between lessees; persons who have acquired the right to remove and retain mineral underlying the leased premises, and mining contractors, who although functionally involved in the production of salable minerals (and therefore financially interested in the life of the deposit as a source of continuing need for their services), have no effective authority over production and acquire no ownership of the extracted mineral." 202 Ct. Cl. at 848, 485 F.2d at 636.

Petitioner does not dispute that the leases are bona fide mineral leases or that, while in force, the leases gave Swank automonous authority over the extraction and sale of the underlying coal. Swank had complete title to the coal he removed and could sell it to whomever he wanted at whatever price he could obtain. Swank looked to extraction of the coal and its sale for his return on investment and profit. He was not required to deliver any coal to lessor at a fixed or fee per ton. The leases were not terminated during the years in suit. These *facts,* which are undisputed, control. Irrelevant are Petitioner's

conjectures about what might have occurred at a different time if the leases had been cancelled or terminated for whatever reason. *Southwest Exploration, supra,* 350 U.S. at 315-316.

Petitioner erroneously characterizes the decisions of the Court of Claims in *Bakertown* and its progeny as a minority view which misconceives the "economic interest" test.[8] In support of this characterization, Petitioner cites contract miner cases which, because of G.C.M. 26290, consider the seven (7) criteria in determining whether or not to allow the percentage depletion deduction to mining contractors. The only cases cited by Petitioner which involve lessees with leasehold interests claiming depletion deduction were decided by the Tax Court. *Winters Coal Co.* v. *Commissioner,* 57 T.C. 249 (1971), *reversed* 496 F.2d 995 (5th Cir. 1974); *Whitmer* v. *Commissioner,* 28 T.C.M. 1480 (1960), *affirmed* 443 F.2d 1970 (3 Cir. 1971); *Charles P. Mullins* v. *Commissioner, supra.* The lessee cases which sustain Swank's position are equally numerous. *Bakertown, supra; Thornberry, supra; Winters Coal Co., supra* (Fifth Circuit Opinion). The Tax Court in *Victory Sand and Concrete, Inc.,* 61 T.C. 407 (1977) even declined to apply the so-called terminability rule. In *Lloyd Weaver,* 72 T.C. 594 (1979), the Court held that a lease terminable on 120-days' notice without cause provided the lessee thereunder with an economic interest in the coal in place. In that case, the Tax Court questioned and criticized *Whitmer* and expressly declined to extend the terminability doctrine, despite Petitioner's urging the Court to do so. 72 T.C. at 607-609. Petitioner did not appeal *Weaver,* and the appeal period expired.

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[8] Petitioner's brief at 19-22.

Petitioner frequently cites *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362 (1938) and *Southwest Exploration, supra.* There is no mention of terminability in the opinions in these cases. The *Bankline* Court even noted that the taxpayer "had no interest as lessor or lessee or as sub lessor or sublessee, in any of the producing wells." 303 U.S. at 366.

The "economic interest" language of Treasury Regulations Section 1.611-1(b) was adopted almost literally from the language of the opinion in *Palmer* v. *Bender, supra,* and has remained virtually unchanged since the regulations on this subject were first issued under the Internal Revenue Code of 1939 (Treas. Reg. 103, Section 19.23(m)-(1). These regulations have never contained any provision, or even a suggestion, of a requirement of non-terminability in order for a lessor or a lessee to be entitled to his equitably apportioned share of the depletion allowance, in accordance with Section 611(b)(1) of the Internal Revenue Code of 1954, and its predecessor statutory provisions.

Petitioner's preoccupation with terminability prefers form over substance. The leases in the cases cited by Petitioner were executed before *Whitmer* (1969) and *Mullins* (1967) were decided by the Tax Court. Before then, no court applied the seven (7) mining contractor criteria to mineral leases. Those cases held that a mining lease containing a 30-day or 60-day termination provision failed to provide the taxpayer with an economic interest in the mineral in place. Prior to that time, terminability was not an issue in mineral leases. Since then, the Tax Court, in 1979, ruled that 120-day termination without cause is not fatal to the lessee under a mineral lease for percentage depletion purposes. Consequently, by merely changing the termination provisions to at least

120 days the lessees assure themselves of their right to percentage depletion allowance under Petitioner's argument. Congress, in enacting percentage depletion allowance, certainly did not intend that this artificial expedient, terminability, decide a lessee's entitlement to percentage depletion allowance, particularly if his lease is not terminated. Instead, the "economic interest" test hinges on whether the taxpayer has (1) acquired by investment an interest in the mineral in place and (2)whether he looks to the income from the extraction of the minerals for a return of his investment. *Paragon Jewel, supra; Southwest Exploration, supra; Weaver, supra.* Swank satisfied these requirements 6-13, *supra.*

C. Only Swank is entitled to percentage depletion and if denied this Congressional entitlement, no other person including lessor, would be entitled to percentage depletion with respect to the coal mined by Swank.

Petitioner at page 22 of the Brief for the United States attacks the position of the Respondent and the opinions of the Court of Claims adopting Respondent's position, by misstating the Court of Claims' opinions in *Bakertown* and this case. The *Bakertown* Court determined that a major factor entitling a similar lessee to percentage depletion was that "unless plaintiffs prevail, no one will be entitled to or receive any *percentage* depletion allowance on the coal removed from the land during the years at issue." 202 Ct.Cl. at 857, 485 F.2d at 642. (Emphasis added).

The Court of Claims in the instant cases stated:

> "Finally, we reiterate what was said in *Bakertown,* 485 F.2d at 642, 202 Ct.Cl. at 857, about the non-availability in these cases of the depletion allowance to the lessors or anyone else. If plaintiffs

> are not entitled, there will be no depletion on the coal mined under these leases" _____Ct.Cl. at _____, 602 F.2d at 351.

Obviously, the *Swank* Court in reiterating its *Bakertown* view was referring to *percentage* depletion, not cost depletion.

What both Courts said is absolutely true and correct as a statement of the results obtaining if the Petitioner's position were to be adopted.

Petitioner confuses cost depletion with percentage depletion, in addition to misstating the *Bakertown* Court's conclusion that only the lessee is entitled to percentage depletion.[9] This case and *Bakertown* involve the lessee's entitlement to percentage depletion, not cost depletion. Under Section 631(c) of the Internal Revenue Code of 1954, as amended, the lessor is not entitled to percentage depletion, but is allowed capital gains treatment on rents and royalties received and must use cost depletion in computing the capital gains. 26 U.S.C. §631(c).

The lessee receives percentage depletion only if he sells the coal which he mines. Mining with out sale is not sufficient, since percentage depletion is based on gross income received from the coal, exclusive of rents or royalties paid by the lessee. 26 U.S.C. §613(a). The lessee's income from the sale of the coal is treated as ordinary income. The lessor's income from rents or royalties paid by the lessee is treated as capital gain, but the lessor must claim cost depletion instead of percentage depletion. 26 U.S.C. §§613, 631(c).

Cost depletion differs materially from percentage depletion. Compare, 26 U.S.C. §611 and 612 with §613.

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[9] Petitioner's brief at 9, 22-23.

Unlike cost depletion, percentage depletion is not related to the taxpayer's basis in the coal. 26 U.S.C. §612. Percentage depletion is "a fixed percentage of gross income which Congress allows to be excluded; . . . bears little relationship to the capital investment and the taxpayer is *not* limited to a recoupment of his original investment." *Southwest Exploration,* 350 U.S. at 312 (Emphasis added). The *Southwest* Court also noted that the percentage depletion allowance "continues so long as minerals are extracted, and even though no money was actually invested in the deposit." 350 U.S. at 312. In this context, the *Bakertown* Court observed, properly, as follows:

> "Unless plaintiffs prevail, no one will be entitled to or will receive any percentage depletion allowance on the coal removed from the land during the years at issue. Under the express terms of Section 631(c) of the 1954 Code, the lessors are 'relegated to capital gains treatment of the royalties received.' *Paragon Coal Co.* v. *Commissioner, supra,* at 636. None of the independent contractors has made a claim for a percentage depletion allowance and, if they made such claims, the terms of their contracts with plaintiffs would preclude them from entitlement to such allowances."

Accordingly, under Section 631(c) of the Internal Revenue Code of 1954, as amended, and the case law, the lessors at bar are not entitled to percentage depletion allowance. They are limited to the cost depletion allowance and capital gains treatment of their rental and royalty income.

Only the lessees are entitled to the percentage depletion allowance which is deducted from their ordinary income derived from the sale of the coal. If Swank is denied this deduction for percentage depletion, no one in the chain of those involved receives the deduction,

and the Congressional intendment that there be allowed a percentage depletion deduction to one party involved in the extraction and sale of the coal is thwarted.

CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Claims must be affirmed and Respondents must be awarded their costs.

Respectfully submitted,

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No. 79-1515

In the Supreme Court of the United States

OCTOBER TERM, 1980

UNITED STATES OF AMERICA, PETITIONER

v.

ELWOOD SWANK and RITA SWANK

UNITED STATES OF AMERICA, PETITIONER

v.

BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA, PETITIONER

v.

BULL RUN MINING CO., INC.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF CLAIMS

REPLY BRIEF FOR THE UNITED STATES

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1. In support of their claims to depletion deductions from their income earned from the sale of coal, respondents each advance markedly different arguments in an attempt to avoid the critical fact that their lessors had the unfettered right to terminate

the leases on 30 days' notice without cause. Thus, Swank asserts (Br. 9-10) that he had an economic interest in the coal in place because his lease effected a sale of the coal under Pennsylvania law. Bull Run, in turn, more broadly contends (Br. 22) that "there is no policy reason why under percentage depletion rules the lessee must have the right to mine the deposit to exhaustion." Finally, Black Hawk dismisses the lessor's right to terminate as "utter[ly] immaterial" (Br. 32).

The decisions of this Court explicitly refute each of these disparate contentions. It has long been established that determination whether a party to a mineral lease has an economic interest in the minerals in place so as to be eligible for the depletion deduction is in no way dependent upon whether the transaction is characterized under state law as a "lease" or a "sale." As the Court observed in *Palmer* v. *Bender*, 287 U.S. 551, 555-556 (1933), "the formal attributes of those instruments or the descriptive terminology which may be applied to them in the local law are both irrelevant." See also *id.* at 557; *Lynch* v. *Alworth-Stephens Co.*, 267 U.S. 364 (1925). Thus, the determination of entitlement to the depletion deduction is a matter of federal law. See *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U.S. 25, 32, 33 & n.8 (1946).

Moreover, it is too late in the day to argue that a claimant for the depletion allowance need not have the right to mine a deposit to exhaustion, or that the lessor's right to terminate is immaterial. As we have pointed out in our opening brief (at 16-18), this Court's decision in *Paragon Jewel Coal Co.* v. *Commissioner*, 380 U.S. 624, 634 (1965), established that the right to mine to exhaustion is an essential element

of a depletable economic interest in minerals in place. As the Court there observed, "the contracts did not fix upon the operators an *obligation* to mine to exhaustion" (emphasis in original). Since the operators did not have an obligation to mine to exhaustion, the Court found a corresponding right on the part of the lessor to terminate. This analysis is fully in accord with the Court's earlier decision in *Parsons* v. *Smith*, 359 U.S. 215, 224 (1959), where the Court held that a mining contractor "had no investment or interest in the coal in place," noting in three separate instances that the contracts "were completely terminable without cause on short notice" (*id.* at 224, 225, 226). Indeed, even in *Bakertown Coal Co.* v. *United States*, 485 F.2d 633, 640-641 (1973), to which the decision below adhered (Pet. App. 5a), the Court of Claims acknowledged that this Court in *Parsons* v. *Smith*, *supra*, accorded significant weight to the lessor's right to terminate on short notice without cause.[1] In sum, it cannot be seriously argued that the lessors' right to terminate without cause has no bearing on respondents' entitlement to the depletion allowance.

2. Thus, the question presented is not whether the lessors' right to terminate a lease on short notice without cause is significant—for all the authorities recognize its significance—but whether, as we submit, it

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[1] Contrary to respondents' argument (Swank Br. 17-22; Bull Run Br. 7, Black Hawk Br. 31-35), this Court's decisions in *Parsons* v. *Smith*, *supra*, and *Paragon Jewel Coal Co.* v. *Commissioner*, *supra*, cannot be distinguished on the ground that they involved contract miners rather than lessees such as themselves. The critical inquiry in those cases (and therefore here as well) is whether the taxpayers had an economic interest in the coal in place, regardless of the particular characterization accorded to them in the transaction.

is to be accorded controlling weight. In this respect, respondents alternatively argue (Swank Br. 5, 22; Black Hawk Br. 21-22; Bull Run Br. 8-9) that terminability of a lease is only one of seven factors identified in *Parsons* v. *Smith*, *supra*, and that they should be entitled to the depletion allowance as long as they satisfy the other six factors.

But this contention overlooks the practical economics of a mineral lease. In a rising market where the market price of the coal rises above the lessor's royalty, the lessor would have every incentive to exercise his right to terminate the lease on short notice and either enter into a more profitable lease or mine the coal himself and sell it. Indeed, this hypothesis is hardly fanciful in light of the current emphasis on coal development as an alternative source of energy that is cheaper than oil. Thus, given the lessors' right to terminate these leases on short notice without cause,[2] it blinks reality to conclude, as did the decision below, that respondents had the right to mine even a substantial portion of the deposits. To the contrary, their continued mining activity was completely subject to the will of the lessors. Since the lessors had the

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[2] Respondent Swank argues (Br. 14-15) that his lessor informally recognized that the leases would be terminated only for cause. But the parties stipulated and the trial judge found that "no assurance was given that the [lessor] *could* not cancel a lease without cause" (Stip. ¶ 15(c), J.A. 55a (emphasis in original)). Noting that respondent "failed to except to those findings" (Pet. App. 7a n.8), the court below therefore specifically rejected respondent Swank's claim that his leases could be terminated only for cause. Moreover, the fact that Swank's lessor, Northumberland County, is a governmental unit that does not need the depletion deduction (see Swank Br. 12) is hardly a principled basis upon which to award it to respondent Swank.

right to assume complete dominion over the coal deposits, they—and not respondents—had the requisite economic interest in the mineral in place.

3. Contrary to respondents' further contention (Swank Br. 14, Black Hawk Br. 29-30), the fact that the lessors' termination rights were not exercised during the taxable years at issue does not cast doubt upon the need to accord controlling weight to those termination rights. The question presented is whether respondents, during the taxable years at issue, possessed a depletable economic interest in the coal in place. That question cannot be answered by post hoc rationalizations that the lessors never exercised their termination rights. If such rights are to be given controlling weight because they diminish respondents' right to extract a substantial portion of the coal in place (G. C. M. 26290, 1950-1 Cum. Bull. 42), their non-exercise does not expand or otherwise alter respondents' legal right over the coal during the years at issue. See also Rev. Rul. 77-481, 1977-2 Cum. Bull. 205. Since the depletion allowance turns on the *right* to extract minerals, the possibility of termination is necessarily fatal to respondents' claim to an economic interest in the coal in place. During each of the years in suit, the only right respondents had was to continue mining for an additional 30 days. Such a right is simply insufficient to establish the economic interest in the coal in place necessary to support a depletion deduction.[3]

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[3] Respondent Black Hawk (Br. 38-39) cites the rhetorical question posed by the Court of Claims in the decision below (Pet. App. 8a) and in *Bakertown Coal Co.* v. *United States*, *supra*, 485 F.2d at 642, observing that this Court need not consider whether the lessors' right to terminate on one day's notice deprives the lessee of the depletion deduction. In re-

Indeed, if respondents were correct in arguing that the lessors' termination rights are rendered insignificant because they were not exercised, depletion deductions would inevitably be left in a state of suspense during the term of such leases. In most cases, depletion deductions will be claimed by either the lessor or the lessee, depending upon the terms of their arrangement. Both cannot claim depletion of the same mineral deposit. *Parsons* v. *Smith*, *supra*, 359 U.S. at 220, quoting *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 309 (1956). If the lessor's failure to exercise a right to terminate without cause could affect the nature of the interest possessed by the parties, then conceivably a lessee who initially lacked an economic interest in the mineral in place could acquire such an interest with the passage of time. By the same token, at the time the tenant-at-will acquired his economic interest by virtue of the lessor's failure to exercise a right of termination, the lessor would to that extent lose his right to claim depletion. Conversely, the lessor's exercise of his right to terminate without cause might lend support to his claim to depletion for years prior to the termination. The confusion that would ensue under such a rule would render the mineral tax laws virtually unadministrable, and would leave the parties to such contracts uncertain of their tax consequences at the time they enter into them. Hence, if the economic interest test is to be administered in a practical way, the party claiming a depletable interest in minerals must

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spondent's view (Br. 39), "no individual or corporate lessee would ever agree to any such economically impossible arrangement." But this very question is now pending before the Court of Claims in the context of a turquoise mining agreement. See *Hardy* v. *United States*, No. 412-77.

be required to establish his interest on the basis of enforceable legal rights as determined under the provisions of the lease agreement. Under that test, the lessors,[4] and not respondents, possess the requisite economic interest to support entitlement to the depletion allowance.

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[4] Respondents continue to argue (Swank Br. 25; Black Hawk Br. 8), as the decision below suggested (Pet. App. 9a), that if they are not entitled to the depletion deduction, then no one will be able to claim depletion on the coal mined under these leases. But, as we pointed out in our opening brief (at 22-23), the lessors' eligibility for the special capital gains treatment under Section 631(c) results in the lessors' entitlement to *cost* depletion. If, however, Section 631(c) is inapplicable, the lessor can claim *percentage* depletion, but must report his receipts as ordinary income (see our opening brief —at 23 n.13). As the Tax Court recently stated in *Davis* v. *Commissioner*, 74 T.C. No. 66 (slip op. 18-19) (July 31, 1980):

> Under section 631(c), the "adjusted depletion basis" of the coal is the same amount as would have been the allowance for cost depletion under section 612. Sec. 1.631-3 (b)(2), Income Tax Regs. The allowance for cost depletion under section 612 is the cost or other adjusted basis of the mineral produced as those terms are defined in sections 1011, 1012, and 1016, generally expressed as cost per unit extracted. Secs. 1.611-2(a), 1.612-1, Income Tax Regs. Thus, section 631(c) operates only upon the coal lessor's gross royalty receipts minus the costs of the coal mined, that is, his net royalty income **or loss.**

CONCLUSION

For the reasons stated above and in our opening brief, the judgments of the Court of Claims should be reversed.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

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